

Part One

WEST GOES EAST

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Chapter 1

Eastern Promises, Delivered

A good traveller has no fixed plans and is not intent on arriving.

—Lao Tzu



Figure 1.1 Picture of a China Visa

This first chapter is an account of what I discovered moving East: the intricate yet essential relationship between Mainland China and Hong Kong and how dominant men have been for Chinese luxury consumption.

Don't Believe the Hype? Come to Hong Kong

As I start a book about Chinese consumption of luxury, I am telling you about Hong Kong. Why Hong Kong and not China proper? you may wonder. Well, in summary, my first shock moving East was to realize Hong Kong is where it all started for the luxury trade, but more importantly, it has been the world's window on China and in turn a very powerful vehicle for China to access the world.

Here are a few important developments that explain why Hong Kong is an essential key to understanding Chinese luxury consumption.

Hong Kong is a cosmopolitan hub. Through its history, culture and location on the Pearl River Delta and South China Sea, the city has become an international destination—leading the local airline operator, Cathay Pacific, to use the tagline ‘Asia’s world city’¹ alongside a picture of a flying dragon—or at least an incredibly powerful bridge between the West and China. It came into being in 1842 when China’s Qing dynasty government was defeated in the First Opium War and ceded Hong Kong Island to Britain in perpetuity. In 1898, China signed an agreement to lease the New Territories, the land North of Hong Kong island along the Mainland China frontier, and more than 200 islands for 99 years.

Hong Kong developed rapidly as a colony, and to this day it has kept a British feel in many areas, from the few remaining colonial administrative buildings and driving on the left to elements of social life through sports, such as cricket and rugby, and the culture of club membership. Many of my English friends in their forties or fifties were born here, grew up here, and even though they may have gone to boarding schools in England, came back and raised their own families and ran their own careers in Hong Kong.

¹ Brand Hong Kong, an initiative of the Hong Kong authorities, launched this campaign in 2001.

Hong Kong has long been a natural home away from home for Mainland Chinese for economic and political reasons. In the late nineteenth century, while some fled upheavals in southern China, others looked to Hong Kong as a natural place to do business as its wonderful harbor had developed into a thriving port. The name ‘Hong Kong’ is a British transliteration of ‘Heung Gong’, which means Fragrant Harbor in Cantonese.

The first really significant inflow of Mainland citizens to Hong Kong occurred when the Pacific war between China and Japan broke out in 1937. By the time Japanese troops occupied Hong Kong in 1941, the population had reached an impressive 1.6 million. By the end of World War II in 1945, that population had been more than halved. The late 1940s saw a surge in population again. With the re-establishment of British rule, many who had left came back. But more importantly, when forces of Mao Zedong² took over China in 1949, Hong Kong became a safe haven for those fleeing communism and poverty. The 1960s were marked by a tough economic environment and tensions linked to the Cultural Revolution in China. In the late 1960s, the population reached close to 4 million souls.

As early as 1982, Britain and China started to have conversations around the future of Hong Kong—what would happen in 1997 when the 99-year-long lease expired. Two years later, with great foresight and pragmatism, Deng Xiaoping³ defined the conditions for Hong Kong to gradually revert to Chinese rule.

Under a principle of ‘one country, two systems’, a transition started in 1997 and was to be completed 50 years later. This is the same path Macau—the only other Special Administrative Region—took in 1999. So, at midnight on 30 June 1997, after five years in the job, the last governor of Hong Kong, Chris Patten, officially handed back control of Hong Kong to Mainland China.

While some people left fearing the transition would not work, Hong Kong’s economy has thrived ever since with the exception of a painful yet landmark event: the 2003 SARS (severe acute respiratory syndrome) epidemic.

² Mao Zedong, a Communist revolutionary, founded the People’s Republic of China and governed it as chairman of the Communist Party from 1949 until his death in 1976.

³ Known as an important reformist, Deng became the de facto leader of China following Mao’s death in 1976. The policy was agreed between the People’s Republic of China and the United Kingdom government.

SARS killed 299 people and devastated the economy. Tourism ground to a halt, retail sales nosedived and the stock market slumped. But from this tragedy an incredible opportunity emerged. In response, in July 2003, Mainland China introduced the Individual Visitor Scheme that enabled Chinese to visit the city without being part of a tour group. That meant the tourism industry and jobs related to it got a phenomenal boost at a time the economy needed it most. And the Chinese visitor numbers and buying power have gone from strength to strength ever since. While you will meet British, American, Australian, French and other non-Asian citizens when coming to Hong Kong, ethnic Chinese represent around 94% of the 7.3 million inhabitants.

Hong Kong has been a symbol of success and a city of hope for many expatriates. By expatriates, I mean expat Gweilos⁴—literally ‘ghost chaps’ in Cantonese (i.e., foreigners), often loosely translated as ‘foreign devils’—like me. Other expatriates also include the ‘migrant worker’ types coming in from China over the decades to live a better life than on the mainland, sending back some money to their relatives who stayed and hopefully one day becoming successful. Success could be found initially in textile and tech and, soon enough, in property, as Hong Kong has little space and many people and businesses. The constant flow of migrants from the mainland was very much part of this success story.

Li Ka-shing, the chairman of conglomerates Hutchison Whampoa and Cheung Kong Holdings, is a great example of how fortunes can be made. After starting out making plastic flowers in the 1950s, he became Asia’s richest man in 2013, according to Bloomberg.⁵ Hong Kong’s economy grew rapidly and the colony became one of the so-called Asian Tigers, making it the ideal connection between West and East.

Although China is essential for the Hong Kong economy, there are a few differences between the Hong Kong locals and mainlanders, linked to language (Hong Kong is Cantonese⁶ dominated while most mainlanders speak Putonghua), politics or economic issues. Whatever

⁴In Hong Kong, locals use this expression without it being derogatory.

⁵According to the Bloomberg Billionaire Index, his assessed net worth in 2013 was USD 29 billion.

⁶Cantonese originated in the area of Guangzhou (Canton) and is spoken in the Guangdong Province as well as in Hong Kong and Macau. It is often written with traditional Chinese characters, while Putonghua is written in simplified characters in Mainland China.

those differences, though, and while Hong Kong is under the ‘one country, two systems’ edict until 2047, mainlanders have started influencing everyday life and, more importantly for this book, have become positively dominant as far as the luxury trade is concerned.

What It All Means for Luxury

The simple fact of China authorities making it easier for its people to travel to Hong Kong has been a great economic driver for the city over the past ten years and a game-changer for the luxury trade. Indeed, before ten years ago, as it gradually became easier to move across from the mainland to Hong Kong, wealth meant becoming successful in Hong Kong and being able to give black-and-white TV sets or rice cookers to relatives who stayed in the mainland.

Before you knew it was happening, luxury handbags and high-end watches were being bought by mainlanders in Hong Kong. The luxury boot is now very much on the other foot: mainlanders used to rely on Hong Kong largesse and spending power; now it is the other way round.

Hong Kong locals have had to accept that Chinese were not only ensuring today’s business but, more importantly, tomorrow’s growth, thanks to their spending. Knowing how to attract these consumers, speak to them, give them advice and please them has become vital in the luxury space for almost any country. Hong Kong shopkeepers have been smart and adapted quickly.

Before landing in Hong Kong, I thought Paris’s Champs-Élysées, London’s Bond Street and Tokyo’s Ginza and Omotesando districts were pretty slick luxury store meccas. Queues generated by Chinese Mainlanders outside Louis Vuitton’s flagship on the Champs-Élysées were a mesmerizing sight, yet an exception, to be fair. Queues in New York exist (or used to exist) outside the more volume-driven Abercrombie & Fitch and Hollister Fifth Avenue stores.

Queues outside most luxury stores on Canton Road in the Tsim Sha Tsui (TST) district of Hong Kong are an everyday feature. And they occur even outside stores of higher-end brands, whether they are Chanel or Cartier, not just the flagship of the more ‘mainstream’ Louis Vuitton or Prada. While the higher-turnover store of many brands used to be the flagship in their home city, today’s reality from both a sales and a margin

perspective is that the largest-grossing store (or building) on the planet is usually the one on that famous Canton Road.

Many investors who have not been in Asia much, despite covering luxury stocks, doubted me when I told them about the endless queues. I ended up sending them pictures to prove that I had not become delusional. It's true that some days the queues are artificial, as certain brands seem to be intent on having consumers wait a bit outside even though the store inside is pretty empty. This is a classic example of retailers counting on the gregarious instinct of shoppers: if people queue outside this store, surely it can't be bad, can it? But generally speaking, queues are real in TST.

In Hong Kong, freezing is good. If you have not been to Hong Kong, think about it as Des Moines, Iowa, but in reverse. Here you can go from one building to the next while avoiding the heat; there, you avoid freezing by taking passages between the buildings. In Hong Kong, you can go around the entire 'Central' part of the Hong Kong Island without having to go out much in the street. Shopping malls and the Central Elevated Walkway enable you to keep well protected from the heat and humidity across the entire Central-Admiralty area. It is a bit like the building connections in Des Moines to avoid freezing.

Often I have been to TST on shopping mall visits—yes, that's my job—and ended up shivering in the Cartier, Chanel, Duty Free Shoppers (DFS)⁷ and Omega stores as the air conditioning was on full throttle.

Intrigued and frankly annoyed as I started sneezing when it was summer outside, I finally asked a shopping attendant why I felt I needed a duffel coat or, better, one of those fashionable Moncler down jackets in their store despite the heat outside, and there I had it: it's chic, it's luxury, it's a sign of wealth, it's for the mainlanders.

And after experiencing it a while, I started to realize that there was a direct correlation between how cold it was and how mainland dominated a shopping district had become. Obvious for all but new to me: Hong Kong retail was not about Hong Kong locals but about retailers tripping over each other—almost literally if you have been over on Chinese New Year or the mid-autumn festival weeks—to cater to mainlanders.

⁷ DFS is one of the biggest duty-free operators with stores in airports but also downtown areas. The LVMH group has a majority stake in this business. DFS sells branded products to more than 35 million travellers every year.

This leads to the most shocking of facts for the luxury sector. Hong Kong, a city of 7 million souls, does as much business in luxury as Mainland China, a subcontinent of 1.3 billion inhabitants.

But you understand, of course: Hong Kong is not about Hong Kong. It's about wealthy Chinese spending abroad.

It is clear that premium retail in Hong Kong takes very different forms depending on how influential Chinese shoppers are from one neighborhood to the next. Ask anyone in the retail business what their top three priorities are and they will often answer with the cheeky 'location, location, location'. If you want to capture the consumers, make sure to be where they want you. Oftentimes for the mainlanders, that has turned out to be Hong Kong.

Chinese travellers tend to spend disproportionately on shopping and very little on accommodation or food compared to the other large travelling nationalities, such as Americans and Germans. While the Champs-Élysées luxury stores in Paris are benefitting strongly from the Chinese flows, Parisian palaces—the George V, the Plaza Athénée or Royal Monceau hotels, for instance—are doing limited business with Chinese consumers.

Hong Kong is even more extreme than those destinations from the shopping point of view. With transport infrastructure and commoditization of shopping implying that, since 2012, statistics for same-day travel from China to Hong Kong have become stronger than for overnight visitors, Hong Kong has become a luxury hub.

Hotel capacity is very tight, given the lack of space, but Chinese travellers spend more than five times as much on shopping as they do on accommodation, allocating 71% of their budget to it while they are over, according to the CEIC data organization (formerly known as the China Economic Information Center). Astounding.

When describing a quick panorama of luxury shopping in Hong Kong, there is clearly a gap between Chinese-obsessed landlords and neighbourhoods targeting group travel and working tightly with tour operators and another set of operators offering differentiation, a greater focus on local Hong Kong aspirations and addressing a more sophisticated, independent Chinese traveller. A bit like avatar Brittany Chen, who may come in from Shanghai for work once in a while but will avoid the Chinese group destinations.

The malls and shopping districts described below are just a few of the most representative of luxury shopping in Hong Kong; by no means is the list exhaustive. And the main idea here is that unlike Mainland China and maybe more akin to Japan, shopping areas in Hong Kong have become extremely segmented.

If you're Chinese and you're coming to Hong Kong to shop for the first time like Lewis Wang did last year, it's statistically likely that you are travelling with a group. And it's also very likely that you will end up visiting either the Kowloon TST neighbourhood and/or the Causeway Bay area on Hong Kong Island. They are the natural luxury go-to hubs.

As a tourist, if you want to see hectic, luxury retail overkill, mono-brand buildings with sky-high rents, beehive-type traffic and luxury being sold literally like cupcakes, there are two neighbourhoods to check out: TST and Causeway Bay.

Nowadays, more consumers from second- and third-tier cities go there because first-tier consumers have seen it all before and may want to shift to less mass-appealing shopping areas. TST and Causeway Bay are such anchors for mainland-driven luxury sales that, between the two of them, Harbour City (in TST) and Times Square (in Causeway Bay), both run by Wharf Holdings Limited, account for close to 10% of total retail sales throughout Hong Kong. For the past ten years, both have enjoyed hefty rental income increases, of about 12% on average every year for the former and close to 9% for the latter according to the real estate company Savills.

Harbour City in TST is the same neighbourhood as Canton Road, Peking Road and the 1881 Heritage building, where many brands from the Richemont group (Cartier, Piaget, IWC, Jaeger-LeCoultre, etc.) and other jewellers and watchmakers have stand-alone stores. The area welcomes tour buses and has the highest concentration of stores for Chow Tai Fook, a Hong Kong-based company and the largest jewellery retailer on the planet, with close to 2,000 stores. (The vast majority are in the mainland, but there are more than 20 locations on Canton Road alone in Hong Kong.)⁸ The retail banner's presence is impressive, and the press has often noted that Chow Tai Fook had as many outlets in China as McDonald's. I am not sure the comparison is that relevant, though the two companies do compete for some of the prime retail locations.

⁸<http://corporate.chowtaifook.com>

Times Square recently welcomed very large Louis Vuitton and Chanel stores and faces Russell Street, the most expensive luxury street in the world, with several jewellery and watch stores, many run by the Emperor group.⁹ Times Square has Lane Crawford¹⁰ as an anchor tenant and, right beside it, electronics stores that are very appealing to mainlanders. Another Causeway Bay landmark, the Sogo department store, one of the main Japanese department store chains, is a long-established magnet for cosmetics and luxury.

Speaking of cost pressures and barriers to entry, these two shopping destinations have gradually gotten rid of many retailers that could not live up to the rental expectations of greedy yet successful landlords. A quite fun and yet somewhat depressing *South China Morning Post*¹¹ article in July 2013 revealed why McDonald's in Russell Street (Causeway Bay) had to move out to give way to SaSa, a cosmetics retailer that is very successful with tourists. The article said that the monthly rent had surged from HKD500,000 (about USD65,000) a month to HKD1,580,000 (about USD205,000)—basically more than triple. Without factoring in the cost of staff, McDonald's would need to sell a Big Mac meal at HKD21 apiece every 35 seconds 24 hours a day just for the rent.

Twenty-four out of 28 stores in Russell Street rely on mainland traffic with 15 selling luxury watches and jewellery.

In Hong Kong, on average, leases are renewed every three years. After the 2009 stimulus, the related liquidity bubble and a strong consumer confidence, rents in all areas of Hong Kong started booming. Today the increases are more moderate. If, say, rents increase 10% to 15% in the future, a brand will 'only' see a 3% to 4% increase a year—as statistically a third of leases renew every year.

With double-digit increases in tourism flows, those rent increases are not too hard to absorb. But given the rental levels some streets have reached, the candidate brands—at least those that are not willing to lose money for trophy locations—are few and far between.

⁹This is a diversified Hong Kong-based group with a watch and jewellery arm specialized in high-end watch retail of partner brands (Cartier, Rolex, Patek Philippe and more than 30 others) and selling its own jewellery ranges.

¹⁰This fashion retailer was founded by two Scots in 1850 and sells luxury goods labels in Hong Kong and China.

¹¹If you have come through Hong Kong, you'll know this remains the city's leading English-language newspaper, known to many as the *SCMP*.

Outside of the mainland-targeting malls and streets of TST and Causeway Bay, many shopping centers pride themselves on targeting mostly local shoppers and as a consequence attract the savvy mainlander. They compete on innovation, capturing the exclusive, edgier brands and being truly cosmopolitan.

Want a nice shopping mall in a central location with a bit of peace and quiet, a cinema and some good food?

Swire Properties¹² seems to have thought about you. The company has been running Pacific Place and City Plaza (both on Hong Kong Island) and used to run Festival Walk in Kowloon before selling it to Mapletree, a Singapore-based real estate development company. All three malls have focused on better servicing the locals and a few high-end tourists staying at the nearby high-end hotels.

With its understated, Scandinavian minimalist touch, Pacific Place's refurbishment was not aimed at mainlanders. It feels empty—which for a luxury shopper is actually the right feeling: I have time, I'm being looked after properly, I am offered some tea and so on, but for store metrics is probably not as great.

Want some street-level stores, a European feel, maybe a VIP salon at Louis Vuitton for a local, relaxed shopping experience? Or do you want the latest hip concepts? The Hysan group¹³ offers you both. The group runs Lee Gardens and Hysan Place in the Causeway Bay area. The former is often described as a tree-lined European-style street and mall chic shopping area.

The latter, opened August 2012, was designed for a younger, trendy, posh local with much buzz initially around the Eslite Taipei bookshop. This is a trendy Taiwan bookstore concept. In Taipei it sells books, of course, but is also a place for youth to hang out, drink coffee, do some shopping—for which excitement in Hong Kong was very strong initially.

You work in finance? Have an office in the Central District and like shops you can access directly from your office tower without having

¹² Swire Properties is a property developer, part of the Swire Group (Taikoo in Chinese), a diversified London-based company.

¹³ Hysan is part of the Hysan Development Company, a property and development company and the largest landlord of the Causeway Bay area of Hong Kong.

to step outside? The Landmark, operated by Hongkong Land,¹⁴ will suit you as it targets high-net-worth locals and, by extension, very sophisticated mainlanders who want a more subtle experience than the TST queues.

This is where Hermes Zhou, our Chinese avatar raised in Canada, purchases clothes at Dunhill and Prada when he's not buying them abroad.

Want a cosmopolitan feel? Want what sells in Paris, Milan, Tokyo but you can't find in Hong Kong? Come to the IFC. It's probably the most forward-looking retail concept and is a consortium among Sung Hun Kai Properties,¹⁵ Henderson Land¹⁶ and Towngas.¹⁷ 'IFC' stands for International Financial Center but is known to some as the Italian Fashion Center.

This is where Brittany Chen comes, as it's close to the Four Seasons, where she stays when she visits for work. She likes the fact she can avoid the TST crowds, get access to hip brands and, compared to the IFC mall in Shanghai, there is much more diversity here in her view.

The mall has brands for all consumers with a mix of fast fashion retailers, luxury, niche/edgy brands—from Brunello Cuccinelli cashmere to Diptyque candles, Moncler quilted jackets, Parisian chic Maje and Sandro dresses and the first store in Hong Kong from French “macaroon legend” Pierre Hermé. It also carries what is probably the most productive Apple store in the world, incidentally the first opened in Hong Kong.

The success story of the IFC lies in its ability to be the first to launch imported brands into Hong Kong, not just Italian, and to make brand boutique managers work hard to make their shops a success. Leases run for three years generally—only Apple likely runs on a much longer contract—but there are breakup clauses for underperformers. That is the reason why, as a consumer, you get the impression there is always something new happening at the IFC.

¹⁴ Hongkong Land is one of Asia's oldest property groups, 50% owned by the Jardines conglomerate.

¹⁵ This is a Hong Kong-based property company.

¹⁶ This is another Hong Kong-based real estate developer.

¹⁷ This is Hong Kong's first public utility, known initially as the Hong Kong and China Gas Company.

Unsurprisingly, the IFC never had Louis Vuitton as a tenant and no longer carries Burberry (both brands having a thorough presence in Hong Kong already) but prides itself on having opened in September 2013 the largest Miu Miu store on the island. Miu Miu has recently become more global, moving from a Japanese and Korean appeal to a much broader one and notably an increasing exposure to the Chinese.

The IFC's insight is the same as in every other cosmopolitan city in the world: as Chinese people travel more and more, they are fast learners, more demanding and knowledgeable. They are looking for the latest concept, the best brands, not necessarily looking to purchase what everyone else has.

Some brands will find it difficult to succeed in Hong Kong. The influence of mainland purchasers is such that these brands will invest mostly to be seen by these tourists as being legitimate, global companies. But when brands do not pass the test convincingly, this could have tough consequences. Brands have had to hand back space.

Pandora, the Danish accessible jewellery brand, shut its store in the IFC shopping mall and Melbourne Plaza (in Central) as awareness was limited in the mainland. FJ Benjamin, the Singapore-based luxury distributor and creator of one of the rare homegrown Asian brands in the sector—RAOUL—shut the Bell & Ross watch store it was running in Hong Kong for lack of success. Shanghai Tang, part of the Richemont group, gave up its flagship location on Pedder Street, and the space was taken by Abercrombie & Fitch to open its first flagship.

For most brands, I believe the future of Hong Kong is bright. While everywhere you turn, you get the impression that there is another luxury store, there are bound to be lot more in the future. It may be odd to hear someone based in Hong Kong say this, but there is probably not enough luxury retail in Hong Kong just yet. Think about it this way: if consumers queue, then capacity needs to increase. Simple market rules, right? And if your brand needs visibility with the Chinese, you'll be ready to push to get a proper location in Hong Kong.

Elements, another mall situated in Kowloon adjacent to the 118-storey International Commerce Centre (the ICC), the city's tallest building, currently caters to a mix of mainlanders and local Hong Kong office workers. I predict that gradually mainland shoppers become dominant there. In 2017, an immense new project will open right near

Elements, and this should boost the Hong Kong appeal further. The 40-hectare West Kowloon Cultural District should be partly open by then, complete with the M+ Museum and several performing arts venues.¹⁸

In 2017, the new Guangzhou–Shenzhen–Hong Kong express rail train should put Kowloon only 12 minutes from Shenzhen.¹⁹ The station and neighbourhood will likely generate more retail opportunities.

What with the beautiful infrastructure of the Taipei 101 shopping mall in Taiwan or massive projects being planned in Macau, Hong Kong may be seen as a retail hub squeezed by up-and-coming neighbours. Macau has gone from being a peaceful backwater with a few rundown casinos to having gaming turnover six times greater than Las Vegas. More recently it has moved from gaming center to broader all-stop shopping, including entertainment and retail.

The hub should continue to strive, however, as Taiwan remains a distant threat with most Chinese tourists there being ‘unqualified shoppers’ for the time being, meaning group travellers who cannot afford luxury goods. Someday Macau visitors will spend more than 24 hours in the city, it is hoped—versus the average 3.4 days spent by visitors in Las Vegas—but this also may take a while, and retail will probably not be the attraction for long.

In the Pearl River Delta, big cities specialize in certain areas. For Guangdong, it’s production; for Macau, entertainment; both Shenzhen and Hong Kong are financial centers. Both are tied for second place after Shanghai as the biggest Greater China container port, but Hong Kong is also well known for . . . yes, shopping.

Hong Kong has replaced Tokyo as the luxury retail hub; rents and sales are by far the highest for the sector of anywhere on earth. If Chinese buyers represent a third or more of total luxury sales, a third of that—that is, about 10%—will be in the mainland, close to a third in Hong Kong alone and the last third in all other regions.

¹⁸This huge project, financed by the government of Hong Kong, is the most ambitious arts and cultural project to date. Work started in 2013 and while a first phase will be opened in 2015, the entire project should be completed only by 2026.

¹⁹Shenzhen is a tier-one city known for being the first Special Economic Zone in China. Shenzhen has become famous for manufacturing and for its container port. In the luxury industry, it is known as an important hub for fakes, notably sold in Lo Wu Shopping Plaza.

The city's retail landscape is *not* finite, and space is harder to find than in the past. Chinese nationals made close to 41 million trips to Hong Kong in 2013 and represented close to 70% of luxury sales, and the numbers keep ticking up. So the city is by no means at full capacity.

The Hong Tourism Board believes that by 2030, total visitors will make 100 million trips, up from the 59 million trips in total in 2013.

Being a duty-free environment is a long-term, sustainable advantage for Hong Kong—unless you take the view that the West will be debt free shortly and can scrap value-added taxes—and price and proximity play an important role in purchases. Hong Kong should remain the go-to destination for Mainland China purchasers in the luxury goods space. Its role in developing awareness and sales will remain paramount.

Guys, Guanxi, Gifting

My second shock as a luxury goods analyst moving East was to realize that the Greater China market was essentially male dominated. (See Figure 1.2 for a humoristic spin on that idea.)

This Is a Man's World

Chairman Mao famously said that “women hold up half the sky,” but until recently, that hasn't really been true for luxury goods in China.

Growing up in the United States and having lived in Paris and London, I had evolved in a world where luxury was by essence a women's world. That applied even to the companies themselves. When I worked at LVMH within Guerlain²⁰—better known for its Shalimar fragrance in the United States—and then at Christian Dior and at Cartier, I was pretty much the only guy in a sea of young marketing female executives. This was helpful as whatever I would say—and hey, I never ended up becoming a marketing guru after all—my thoughts were valued as being those of the rare male representative in meetings. I felt smart even though I was average.

²⁰ Guerlain is one of the oldest—founded in 1828—and most successful brands in France for fragrances and the company that was brave enough to give me my first proper full-time job. Guerlain, like Patou and Chanel, remains one of the rare fragrance manufacturers with an in-house nose (something that is being replicated by other brands now for marketing purposes) and with an extensive use of natural, rare (and thus expensive!) raw materials.

Ladies, you ride our Harleys, smoke our Havanas, drink our Glenmorangie. Hands off our IWC!

Let's face it. No one's more qualified to
fuss over a Portuguese split-
seconds chronograph. A mechanical
chronograph with a fly-back hand
which measures intermediate elapsed
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Figure 1.2 IWC's Sense of Humor: Watches for Men
(CREDIT: IWC)

Back to Asia. Men dominate the queues in the Hong Kong TST district. It is outside the Louis Vuitton flagship on Canton Road that I met Lewis Wang last October. Lewis had flown in from Xiamen with three of his business partners, all men, and they were queuing with a mostly male-dominated crowd to get their LV manbag.²¹ I was surprised, as I thought mostly women buy Louis Vuitton products, but this soon became a common sight for me.

While LVMH would never disclose much on its core brand Louis Vuitton, not even global sales, several of its competitors have told me that 52% of their sales in Mainland China are made with men for men. I know that sounds almost too precise.

So let's say half of their sales in China are made with men for men, meaning men buying for themselves or for other men. Sounds counterintuitive, right? This is not to say that the market is dominated by the metro sexual²² consumer. It's just that men have been purchasing goods that enable them to display their wealth, and in Chinese society, men have been the breadwinners so far. Besides, gifting, whether politically driven or linked to business, has been a common practice.

When talking to avatar Brittany Chen, she explained that Chinese men enjoy shopping more than women. Besides, in her view, usually space at home is limited. People don't traditionally invite others to their homes for drinks or dinner. Since you cannot show people at your place your wealth and status, you might as well wear it!

Guanxi and Frustration of the Masses

Guanxi (关系) is a pillar of Chinese society and describes personal relationships and networks of influence by which an individual can receive favors from another. Being naïve about all things Chinese when I landed in Hong Kong, I thought guanxi was a polite word for corruption or a form of bribery. In actual fact, it is far subtler than that.

²¹ A manbag is basically a handbag or shoulder bag for men.

²² Literally 'metropolitan heterosexuals', a neologism created in 1994 to describe men meticulous about their appearance and spending more time and money than average men on shopping.

When someone manages to solve a tough problem thanks to his or her interpersonal skills, the person is said to have good *guanxi*. To a certain extent, it is a form of networking. Traditionally, displaying wealth in China is driven by more than just status seeking for the sake of it but is regarded as an important tool for achieving financial or career success.

In Chinese society, *guanxi* or relationships are widely recognized as being the key determinant of business performance and are often linked to making gifts and giving favors.

But it's also very much in the Chinese culture to return favors and, for instance, bring back a gift from a trip to a relative or a business partner.

Such corporate gifting is accepted as necessary for building relationships. Every time Brittany Chen travels to Hong Kong, she buys souvenirs for her co-workers.

It is when *guanxi* involves corporate gifting that the link with corruption and bribery practices comes to the forefront. As Chinese become more connected via blogs and forums, the behavior of the political elite gets scrutinized ever more closely, and the frustration of the masses with a few political figures can increase.

Slower gross domestic product growth and recent corruption scandals have also undermined corporate gift giving. Examples of corrupt practices have abounded recently with the change in administration in the autumn of 2012 really seeing a greater intensity on these topics. Indeed, Xi made it clear early on that his administration would be looking to project a clean image and a zero-tolerance attitude.

According to *The Cult of the Luxury Brand: Inside Asia's Love Affair With Luxury*,²³ showing off wealth in China can trigger a virtuous circle in which 'if you are seen to be rich and successful, you can attract more business deals, and you win approvals faster from officials who know you have the means to make appropriate gifts and donations'. The book estimates 50% of luxury sales—and as much as 75% of sales in the watch category—are driven by gift giving, both corporate driven and otherwise.

²³ By Radha Chadha and Paul Husband, 2006, published by Nicholas Brealey International.

Based on conversations with boutique managers, retail operators and brand CEOs, I believe the reality is that:

- Gifting is not that dominant in their sales.
- Getting an accurate estimate is pretty difficult. Boutique managers don't really know so their managers know even less.

If you're running an Omega store and a man buys the same watch model five times, presumably it is for gifting, business to business or politically driven.

But what about all the men who buy a watch and have it wrapped? Any bold statement on what the real percentage is should be taken with a pinch of salt.

In watches, Rolex is the reference, and after that Omega and Cartier might do. If I get a Rolex, I know what it is worth, I know it is the universal reference in watches; I know its theoretical retail resale value. Omega is slightly lower priced, so it won't be seen as good a gift but it is still decent. Cartier is more the feminine brand in watches and can be used for a partner's wife. Other brands won't do.

Why? Well, imagine you buy a Blancpain or a Vacheron Constantin for a business deal: you will be paying more, but you run the risk that the counterpart will not know it, so you lose the whole point of having traded up. Conversely, if you give a corporate partner a Longines or a Rado, he might think that's just not good enough.

Xi Is Serious

On 8 November 2012, a week before passing the baton to Xi Jinping, Hu Jintao²⁴ gave a keynote speech at the party congress. Much of the speech revolved around anti-corruption, keeping the masses happy, setting the example. Corruption was mentioned as being a 'life-or-death struggle' for the party and China overall.

Many cynical investors told me at the time: 'It's like parents telling their kids to stop playing video games. Shut the door and they will start playing again'. Well, it looks like the parents have changed and they really mean it. The second plenum of the Central Commission for Disciplinary

²⁴ He was president of the People's Republic of China from 2003 to 2013.

Inspection took place late January 2013, and Xi Jinping, the party general secretary, vowed to an unswerving fight against corruption.

This is consistent with the introduction of the ‘Eight Musts’²⁵ by the Xi administration, a new reformist leadership for China, and some locals have called it ‘Xi8’. The commitment is to capture all levels of corruption in all ranks, whether ‘tigers’ like senior officials or ‘flies’ (i.e., the rank and file).²⁶

Some have commented that a Chinese administration clamping down on corruption and guanxi gift-gifting practices is *déjà-vu* and won’t work. Many bloggers in China took the view that yes, corruption is a key issue, but that it is completely entrenched in the system and that the system would never structurally change. Beyond the categories that are traditionally used for gifting, all premium products suffered starting at the end of 2012 in China, given the political peer pressure and logical paranoia in China. In other words, consumers buying for themselves became more self-conscious and subtle in their purchasing behaviors. Similar to Russia’s government, which had passed a message of containment to local authorities a few years back, the Chinese ruling body also wanted to prevent the wealth gap from becoming too visible.

In the first few months in office of the Xi administration, anti-corruption messages multiplied in the press, bans on officials accepting gifts like alcohol and tobacco were made public and the general environment for gifting became ‘wait and see’. At the third plenum²⁷ held in November 2013, some comments reiterated there was a will to increase taxes further on some luxury items, though details remained scarce.

²⁵ Introduced in December 2013, these are eight principles that will guide the new administration. As published in English by China Digital Times: ‘We must persist in the dominant role of the people; we must persist in liberating and developing social productive forces; we must persist in moving reform and opening-up forward; we must persist in safeguarding social fairness and justice; we must persist in marching the path of being well-to-do together; we must persist in stimulating social harmony; we must persist in peaceful development; and we must persist in the leadership of the Party’.

²⁶ Xi has stated: ‘We must uphold the fighting of tigers and flies at the same time, resolutely investigating law-breaking cases of leading officials and also earnestly resolving the unhealthy tendencies and corruption problems which happen all around people’, as reported by the *China Digital Times* in January 2013.

²⁷ The third plenum of the Communist Party’s Central Committee is by far the most important. The first plenum is an introduction to the new leaders and the second runs personnel changes. The third is thus the first real plenary session where policies are fully presented.

The trigger that has probably affected luxury consumption most in China over the past years or at least has been the most televised and followed has been the scandal involving former political star Bo Xilai. Bo was Chongqing²⁸ party secretary from 2007 to 2012 and former minister of commerce and member of the Seventeenth Politburo.²⁹ He was accused of diverting public funds through the business ventures of his wife, Gu Kailai, who is incidentally currently serving a ‘suspended death sentence’ after being convicted of murdering a British businessman.

In the 1990s, the Cognac market in Japan went from boom to bust, forcing brands like Hennessy to rapidly expand in other markets to make up for the sudden slump. What happened was quite simple. Corporate expenses initially boosted Cognac consumption. Companies would take their clients out to upscale restaurants and karaoke bars and treat them to the finest on offer. Some years later, business rules tightened, and the market for Cognac fell off a cliff as corporates were no longer expensing it.

Has this happened to luxury consumption in China?

Certain subsectors have indeed suffered since October 2012, notably including those for which an important number of transactions were business led (rewarding a colleague, gifting a business partner or a prospect). These include baiju³⁰—a traditional Chinese white spirit that is often consumed at banquets—and high-end watches, the more male-driven categories, while in ‘soft goods’—apparel, handbags and accessories—only Louis Vuitton and Burberry mentioned that gifting was relevant in terms of their sales in China.

Since the new administration adopted tougher anti-corruption governance practices and policies, luxury demand started to lose some steam.

As far as luxury consumption is concerned, a big trigger for the anti-watch sentiment was the incident of the so-called smiling official in

²⁸ Chongqing was made a municipality and separated from Sichuan Province in 1997. Though the city itself has ‘only’ 7 million inhabitants, the municipality includes 34 million. Chongqing is situated in Central China and has become an important manufacturing and transport hub. It was also the provisional capital of China from 1937 to 1945 during the war with Japan.

²⁹ The Central Politburo Standing Committee of the Communist Party of China, consisting of the top leadership of the Communist Party with seven Standing Committee members. The Eighteenth Politburo was elected on 15 November 2012.

³⁰ Baiju is probably the world’s most consumed spirit, ahead of vodka. It is a strong clear alcoholic beverage usually made from sorghum or sometimes, in the South, from glutinous rice. It has been described as China’s vodka and is more similar in strength to vodka than it is to Japanese shochu or Korean soju. Leading brands are Wuliangye and Kweichow Moutai.

the bus crash in August 2012 in Shaanxi, in northwestern China, where 36 travellers were killed.³¹ A safety official at the scene of the road crash scene was spotted grinning and later was revealed by web users to be wearing many different luxury watches. Since then, other ‘luxury-watch-wearing’ officials have also been discovered and their pictures posted online.

In September 2013, Yang Dacai, the ‘smiling official’, was given a 14-year jail sentence for corruption after pleading guilty, as he could not explain how he amassed wealth of RMB5 million (USD800,000).

This is a story that Calvin Li had not heard about but was reported to him by his cousin Lewis Wang. Given Calvin’s limited means, the story did not go down very well.

There was also the story of the deputy secretary general of Fushun in Liaoning Province in northeastern China, on the western border with North Korea, who possessed 253 Louis Vuitton bags (and 48 Rolex watches) and was sentenced to life in prison for taking bribes.³² The minister of publicity in Guangzhou was discovered to own a number of Cartier watches after fighting with a flight attendant on an airplane.³³

Since the summer of 2012, it seems there hasn’t been a week without an article related to anti-corruption in the *South China Morning Post* or mainland papers.

The anti-corruption campaign that started with the new China administration coming in has been well advertised.

In early February 2013, the press reported three elements of news in the same week:

1. A *Times* article on clamping down on Triad-linked junkets³⁴ operating in the gaming business in Macau
2. A ban on TV and radio advertising with the term ‘gifting’ from the State Administration of Radio Film and Television of China
3. A State Council reform to ‘reasonably adjust consumption tax for entertainment and high-end luxury goods’

³¹ *Global Times*, 21 September 2012.

³² *The Star Online*, 21 September 2012.

³³ NDTV, 13 September 2012

³⁴ Junket operators in Macau extend credit to gamblers coming from China in exchange of a percentage commission on the funds. Junkets still account for the bulk of the gaming business in Macau.

On the TV/radio ban of the ‘gifting’ term, the State Administration of Radio Film and Television of China said ads that promote gifting—that is, that emphasize the expressions ‘ideal for gifting’ or ‘best for leaders’—promote bad social ethos and incorrect values. The direct impact of this ban on imported brands was probably minimal. Imagine if a Louis Vuitton Sean Connery ad had a tagline ‘best for leaders’ on it. That’s not really Vuitton’s style. But the psychological impact of conveying the message ‘abandon your privileges’ was probably quite powerful.

The State Council tax comment is one to monitor closely. The document ‘About deepening the reform of income and distribution system’ was distributed to all state governments and government institutions.

The document says that the administration should ‘reasonably adjust some of the items and rates for consumption tax, adding high end entertainment and high end luxury into taxable items’. However, there are no precise details on the exact categories or rates to be applied, and none on timing either.

Why is this relevant? Mostly because the sense of history would probably lead Chinese authorities to ease (rather than increase) the consumption tax, which is already quite high on a few items (30% on cosmetics, 20% on watches retailing at more than RMB10,000 [the equivalent of around USD1,600]).

I have also heard the view that ‘what happens outside of China stays outside of China’—in other words, that gifting practices had relocated outside the mainland frontiers, notably in Hong Kong. There is no evidence that this is the case: business-to-business or government official gifting takes place in China, so the person who receives the gift can theoretically exchange the gift at the store it came from. Also, gifting occurs once a deal is done, meaning you don’t necessarily have time to fly out to purchase an item to celebrate closure of the deal. So gifting is a local thing, really.

Addressing the gifting issues has been seen as one of the great moral successes of the current Chinese administration and a healthy approach for the sector. Peer political pressure has also had an influence on the types of brands and designs Chinese consumers were going for; more discretion was enhanced by travel, sophistication but clearly also the need for more subtle products.

Coco Chanel once said: 'Hard times arouse an instinctive desire for authenticity'. Whether hard times are triggered by a soft economy or a lack of consumer confidence, subtlety is always a healthy reaction.

Same Same?

The jury is out still on whether the anti-corruption campaign from the Xi administration can really change practices permanently, but so far the approach has been quite efficient. Interestingly, there are stories relating to corruption issues dating from centuries ago.

Corruption is said to be at the origin of one of the great festivals, the Duanwu or Dragon Boat festival, which takes place on the fifth day of the fifth lunar month and is a bank holiday in Hong Kong and China.

The story says that poet Qu Yuan, a minister who lived from 343 to 278 BC, committed suicide to protest the corruption prevalent among officials at the time. Villagers took to their boats looking for the poet, beating drums and splashing paddles to keep the evil spirits in check. Nowadays dragon boat races are common in Hong Kong and coastal cities of Guangdong, and some people train for weeks to race their boats on the big day.

There is nothing to indicate that the current administration would take a less strict line on corruption practices. I tend to think that the anti-corruption campaign will continue to prove efficient. But cynics may disagree. One I met in Singapore recently said: "Gifting gone? No, my friend, *same same but different!*"

That's one of my favorite expressions in Tenglish³⁵ and is both funny and very useful. In a Bangkok market, ask peddlers selling fake Louis Vuitton bags if they are real. The response: *same same but different*. You order some food and the waiter brings something that's probably as good but clearly not what you thought: *same same but different*. It's a fantastic concentrate of the relaxed attitudes of parts of Southeast Asia.

So why use this expression for Chinese corporate gifting? Well, diamond-encrusted watches and logo-heavy handbags are not flying off the shelves following the clampdown on corruption, but gifting may

³⁵This term is used for English as spoken by some native Thai speakers.

have reappeared already in a more subtle, indirect fashion. You do not want to go against the policies of a new administration that means to show exemplarity to the people.

Apparently the up-and-coming trend in the summer of 2013 was to offer massage chairs like the ones from the Osim brand. It is a discreet gift, as you enjoy it at home instead of displaying it in public. Guanxi is entrenched in the Chinese culture. Over-the-top, obvious gifts may have taken a hit, but the practice continues in slightly different form.

Same same but different, really.

So is gifting back or not? I believe gifting will not come back on luxury goods as the administration would suffer the consequences. But, yes, it may be re-appearing elsewhere. I personally hope it will not come back at all as a sector driven by self-purchasing and personal gifting should see more consistent—rather than volatile—growth.

The Future Is Female

Many consumers from different nationalities are beginning to enjoy luxury consumption. Notable among them is the fast growth of Young Urban Males (Yummies—or the modern-day metro sexual). While Chinese consumption is also young and urban, it is becoming more female driven.

If you stop and think about the fact that China is an exception, being the only male-driven market for luxury goods, I think there is only one possible outcome gender-wise.

The future is female.

No doubt.

And I believe the Chinese market will converge towards the markets in Japan, Western Europe and the United States over the next five years, meaning that it will be dominated by female-driven categories, such as jewellery and handbags, rather than watches and premium cars. I wouldn't be too pessimistic on the watch front however, given that women can also drive sales in that category.

Gifting was mostly male driven and has been mostly taken out of the luxury sales equation thanks to the thorough and systematic policies of the new Chinese administration. Besides, as in all developed markets,

women are developing much more financial autonomy in China, and they have started to significantly move the needle on the imported jewellery brands such as Cartier, Bulgari and Tiffany.

In a book called *The End of Men and the Rise of Women* (Riverhead, 2012), Hanna Rosin explains how women are much better adapted to the modern world's constraints, particularly from a workplace perspective, and how this will soon change everything in society the world over. While women have dominated the luxury world for a while in Western and Japanese society, in China it is just happening now.

Recently many brands have increased their presence on 'out-of-home' advertising—that is, billboards—in Asia. If you were in Macau or Hong Kong in 2013, it was pretty difficult to miss the Miu Miu ad with the two French actresses from the 2013 Palmes d'Or movie *Blue Is the Warmest Colour*, Léa Seydoux and., respectively 28 and 20 years old at the time. (See Figure 1.3.) Christian Dior also was very present with 23-year-old American actress Jennifer Lawrence. Models in the ads are as young as potential up-and-coming Chinese female consumers.



Figure 1.3 Miu Miu: Targeting Young Female Consumers

(PHOTO CREDIT: Inez and Vinoodh, New York, July 22, 2013)

Targeting the Sophisticated Consumer

Interview with Karim Azar, IFC Shopping Mall General Manager

ER: How does the IFC mall stand out from other luxury destinations in Hong Kong?

KA: We have the most diversified trade mix in Hong Kong, with 205 tenants of different origins, including many internationally accepted, successful brands, with unique positionings that appeal not only to mainlanders but to the local, sophisticated Hong Kong crowd. We are known for bringing new brands to the Hong Kong market such as Tom Ford, Loro Piana, Zara, Aldo, Nespresso, Pierre Hermé, Kate Spade, and Tory Burch, Brunello Cucinelli, Moncler and many more. So the consumer recognizes that edge.

We have a very active management policy and help tenants improve on a constant basis. Also, we remain on the lookout for the latest trends coming from Japan, Europe and the United States. We never sit still and reject complacency. We keep the churn rate relatively high on purpose as a way to keep inviting new brands in. In any given year, there will be 40 to 80 moves, and that keeps the brand mix fresh and the shoppers enthused and engaged.

ER: Who are your anchor tenants and what role do they play?

KA: We have very strong performing stores from Apple, Zara, Lane Crawford, City Super [supermarket] and cinemas. You don't want to have too many anchors, but they are undeniably huge traffic generators. The consumers are omnivores, wealthy ladies buying expensive brands will also purchase items regularly at Zara and Apple. It's an open world.

ER: What is the right balance of brands?

KA: We were 'over-restauranted' with food and beverage representing initially up to 30% of our business.

That was a good way to generate the initial traffic flows but as that business is less profitable, we should come down to a sweet-spot level, closer to 20% contribution eventually.

ER: Why do locals shop here, and what about the mainlanders?

KA: Hong Kong locals can find brands that are not all over town. Besides, the restaurants are great and the proximity to the Four Seasons hotel as well as the airport express is a huge advantage for all. Local businesspeople like to shop at City Super for quality food, and the average ticket there is great relative to most supermarkets in Hong Kong I can think of. Mainlanders are drawn by the Apple store but also high-end apparel brands like Zegna and Moncler as well as rare cashmere brands such as Brunello Cucinelli and Loro Piana for which the merchandise in Hong Kong is different, more stylish, closer to the taste of Hong Kong ladies and also more affordable here than in the mainland.

ER: How has the increase in travel changed the way you do business?

KA: Chinese are going further afield but look at Hong Kong as a template and a place to get inspiration and fashion sense. Many consumers dream of becoming Hong Kongese, so the Hong Kong lady is really a proxy. As the Chinese go further afield, they will see that the brands we sell are the true cosmopolitan ones, they are legit. We benefit from our tenant mix but we are not actively marketing only to mainlanders. We have a much wider scope of targeted consumers. We have no in-flight or airport ads in China, no tie-ups, the Four Seasons' proximity is a good association, but many Chinese shop here as we get very positive word of mouth.

ER: Are Macau and Singapore threats to Hong Kong luxury retail?

KA: I doubt the mainlander will go to Macau and not to Hong Kong. Shoppers will travel and look around but eventually come back to where they are the most comfortable. Hong Kong still offers the best shopping experience. Singapore retail might be good but it's a bit hot and a bit far for mainlanders.

Summary

An Asian beginner's first impression has told me that:

- Hong Kong luxury retail has been created and transformed by the dominant Chinese travellers.
- Chinese luxury consumption is still male dominated for cultural, financial and guanxi (relationship-building) reasons. The recent anti-corruption measures from the Xi administration have tempered the guanxi influence and implied a move towards more discretion.