Luxury Without Borders: China’s New Class of Shoppers Take on the World
The McKinsey Chinese Luxury Consumer Survey

Luxury Without Borders:
China’s New Class of Shoppers Take on the World

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Contents

Executive Summary ........................................................................................................... 6
A booming market, with challenges aplenty ................................................................. 10
Growth drivers: Why China is No. 1 in luxury consumption ............................. 14
The transformation of Chinese luxury consumption ....................................... 20
  • China’s globetrotting shoppers .................................................................................. 21
  • Gaining sophistication, with impressive speed ...................................................... 24
  • The battleground for luxury shoppers: The store ............................................. 25
  • Luxury shopping online: Still testing the waters ................................................. 26
Winning over Chinese luxury shoppers ............................................................... 30
Executive Summary
Growing at a pace far surpassing expectations, spending by Chinese consumers on luxury products now exceeds that of any other country. Having leapt past Japan’s luxury market, which until recently was the world’s largest, China has become the paramount driver of growth in this sector, with purchases by Chinese both at home and abroad accounting for over one-quarter of the global total. China’s current economic slowdown has caused the growth rate in the country’s luxury spending to subside recently, and another factor leading some consumers to become more wary is heightened concern about corporate gifting to government officials. Even so, the nation’s share of global luxury spending will continue to soar, to more than one-third by 2015.

This extraordinary boom prompted us to expand upon our previous findings about Chinese luxury shoppers by undertaking another in-depth study of this market, which McKinsey has been following closely for the past half-decade. Our research is based on face-to-face interviews with over 1,000 luxury shoppers in 14 cities¹, as well as extensive data analysis and conversations with industry insiders.

Despite the cooling in the growth rate of Chinese luxury spending, a number of factors will ensure that demand remains relatively robust. These include the rising number of very wealthy consumers, who have a marked tendency to trade up to more expensive and more luxurious products. At the same time, new entrants into the luxury category – those just attaining middle-class status – are increasing at an explosive rate as incomes head upward. Moreover, levels of financial confidence in China are astonishingly high; around three quarters of the country’s affluent consumers believe their household incomes will increase significantly in the next five years. The rising purchasing power of women is yet another growth driver. And gifting by individuals shows every sign of staying strong or even increasing, while the decline in corporate gifting may well prove a temporary phenomenon related to the transition of the nation’s leadership.

Despite all the forces fostering growth and increasing sales, this market is also changing fast, in ways that make it harder and more expensive for luxury brands to

¹ The interviews, which lasted 35 to 45 minutes each, took place in three Tier 1 cities (Beijing, Shanghai, Guangzhou), eight Tier 2 cities (Qingdao, Hangzhou, Chengdu, Xiamen, Xi’an, Shenyang, Wuhan, Nanning), and three Tier 3 cities (Baoding, Maoming and Huhehaote).
to win over the nation’s consumers.

A rapidly-growing share of Chinese luxury shoppers are doing their purchasing abroad – and although Hong Kong and Macau rank among their favored shopping destinations, Europe is also rising quickly in popularity. Increasing foreign travel by Chinese is one important reason for this trend; so is the fact that luxury goods are not nearly as expensive overseas as they are in the Mainland, where the government imposes stiff taxes on such goods. About half of Chinese luxury spending currently takes place abroad, our research indicates. This phenomenon raises the danger that a brand may lose consumers’ trust if its stores or products fail to present a consistent image both in China and elsewhere in the world.

Furthermore, Chinese consumers’ tastes in luxury products are maturing with surprising speed. Shoppers with just a few years’ experience as buyers of such products increasingly prefer low-key and understated goods to ones that are emblazoned with popular logos. Yet the market is splintering, because the fast-growing numbers of new entrants still favor widely-recognizable brands that show off their status. As tempting as it may be for firms to try satisfying all kinds of consumers, doing so risks diluting their brands’ cachet.

Finally, the in-store experience is proving increasingly important in this market as the key touch point for consumers making decisions about buying luxury. Respondents to our survey heavily attributed their choices to a variety of aspects concerning the experiences they had in luxury boutiques. A rapidly-growing number of them reported buying on impulse, or after only brief consideration, highlighting the cruciality of the in-store factor. For ultra-wealthy consumers (see sidebar, page 18), providing a VIP shopping experience, with private rooms and dedicated salespeople, is essential, as is establishing effective customer relationship management programs. As for online commerce, which is exploding for many consumer products in China, the amount in the luxury sector is still small, but experimentation is taking place and this channel cannot be ignored.
A booming market, with challenges aplenty
Glowing with optimism about their futures, Chinese consumers have leapt into first place among the world’s spenders on luxury goods. China’s market for luxury was dwarfed by Japan’s a few years ago, but Chinese spending on pricey and prestigious brands at home and abroad has grown at such a breathtaking pace, far exceeding expectations, that it now accounts for more than one-quarter of the global total.

This trend is only going to strengthen. Having already become the paramount driver of worldwide growth in the luxury sector, China will continue to gain importance in this market over the next several years, despite the nation’s current economic slowdown. By 2015, barring some unforeseen events, more than one-third of the amount spent globally on high-end bags, shoes, watches, jewelry and ready-to-wear clothing will come from Chinese consumers, whether in the domestic market or outside the Mainland (see exhibit 1).

But lucrative as this market may be, it is undergoing tumultuous changes that confront luxury-goods makers with formidable challenges. As the savviest

Exhibit 1

<table>
<thead>
<tr>
<th>Year</th>
<th>Chinese Consumers</th>
<th>Other Worldwide Consumers</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>14</td>
<td>86</td>
</tr>
<tr>
<td>2010</td>
<td>19</td>
<td>81</td>
</tr>
<tr>
<td>2012</td>
<td>27</td>
<td>73</td>
</tr>
<tr>
<td>2015E</td>
<td>34</td>
<td>66</td>
</tr>
</tbody>
</table>

CAGR Percent

<table>
<thead>
<tr>
<th></th>
<th>2008-2012</th>
<th>2012-2015E</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>8</td>
<td>6-8</td>
</tr>
<tr>
<td>Other</td>
<td>4</td>
<td>3-5</td>
</tr>
</tbody>
</table>

1 Luxury goods include fashion ready to wear, shoes, handbags, watches, and fine jewelry
2 2012 real RMB. Fixed exchange rate 1 USD = 6.284378 RMB

brands have learned, simply building lots of stores in Chinese cities and offering merchandise emblazoned with famous logos is not nearly sufficient for reaping the rewards that this market offers.

More and more Chinese spending on luxury – about half the current total – takes place outside the Mainland. This is chiefly attributable to the growing ease and appeal of overseas travel for Chinese, and the high taxes that make luxury goods sold in domestic stores much more expensive than those sold abroad. Brands are therefore obliged to maintain consistency of excellence in their retail establishments around the world. Chinese government officials have been reviewing proposals to reduce some of the tax burden, with the goal of bringing more consumption back home. But the price gap is likely to remain substantial in the next two to three years, and assuming it does, Chinese spending on luxury goods will grow about as fast overseas as it will domestically.

Chinese demand for luxury is in a state of flux across income levels and social classes. Sophistication is taking hold with remarkable speed among tenured consumers – those who have been buying luxury for some time. Tenured Chinese consumers increasingly tend to shun flashy products in favor of ones with understated styles. To distinguish themselves from more common buyers, they enjoy discovering smaller brands, ever-more luxurious items, or rare offerings. At the same time, there is continued and even accelerating growth in the number of consumers who have just reached income levels at which designer labels become affordable. These recent entrants to the luxury market tend to crave products that clearly display their newfound status, often from brands that are widely recognizable. With both groups growing rapidly, the market is diversifying, and luxury-goods makers face complex choices about how to tailor their product portfolios. It is becoming increasingly difficult for them to achieve sales growth without risking their brands’ exclusivity and cachet.

The importance of the in-store experience for Chinese luxury consumers is becoming ever more evident. The ultra-wealthy (those with liquid household assets above RMB 100 million), a fast-growing and increasingly crucial segment of brands’ clientele, expect the most regal treatment – and they are often getting it, with their perks including personalized service from brands as well as private shopping areas and even expensive trips. But providing an ideal shopping environment is the key to winning all kinds of luxury consumers, not
just the richest – one indication being that impulse purchases are rising sharply. Enhancing the in-store experience is becoming an increasingly expensive proposition; store rents and labor costs are also on a steep upward trajectory. The result is that some brands are facing tough trade-offs between the number of shops they have and the quality of service they offer. To monitor their best customers and secure prime sales opportunities, luxury brands must develop and strengthen customer relationship management programs – using data collected from a variety of consumer activities to determine who the high-potential customers are, and maintaining one-on-one ties with them. At the same time, companies can’t ignore online commerce, a channel where a small but fast-growing amount of experimentation is occurring even in the purchase of designer products.

The firms that can overcome these challenges will gain the riches flowing from a variety of forces that are enabling and impelling the Chinese to spend more on luxury.
Growth drivers: Why China is No. 1 in luxury consumption
For the past four years, consumption of luxury goods in China’s domestic market has surged at rates of between 16% and 20% per annum. That pace of growth is subsiding, to a projected annual rate in the 12% to 16% range between now and 2015. In part, this is attributable simply to the rising tendency of Chinese to buy luxury goods overseas instead of at home, though it also stems from factors that are causing people to curb their overall purchases somewhat. One such factor is the concern that some consumers have about the nation’s broader economic course. Another factor is tension over expensive gifting practices between businesses and government officials, combined with uncertainty related to the change in the nation’s leadership—which has had a marked effect on such gifting.

Even a 12% growth rate is much faster than that in other countries, however. As a result, the Chinese share of the global market—including spending by consumers outside the country—is certain to rise further in the next three years, to about 34%.

In a previous report, titled “Understanding China’s Growing Love for Luxury”, which was based on a 2010 survey of consumers, we identified the growth drivers that were then most important in this market. They included rapidly rising incomes, the wide availability of luxury products and information about them, and shifting social attitudes toward the display of wealth. With the data from our latest survey, taken earlier in 2012, we are able to further pinpoint, refine, and update the chief factors behind this extraordinary boom:

Much of the growth in Chinese luxury purchases stems from the rising number of very wealthy households (i.e., those with annual disposable incomes above RMB 1 million). The number of very wealthy households will grow at over 20% annually in the coming 3 years. Not only are their ranks swelling; so is their tendency to trade up to more expensive and more luxurious products. This group will account for 28% of luxury consumption by 2015 (see exhibit 2). At the same time, from a much lower end of the income scale, growth in luxury spending is coming from new entrants into the category—who mostly belong to China’s mushrooming middle class (those with annual household disposable incomes in the RMB 50,000 to 250,000 range). Even though each of these households spends much less than the typical wealthy household,
their numbers are increasing so impressively that they will also make a major contribution to the additional luxury spending we project to occur by 2015. China’s Tier 2 cities are where many of these new entrants are likely to live. Although about 60% of luxury spending will continue to take place in the nation’s 12 largest and wealthiest cities, faster-paced growth will likely occur in smaller metropolises.

Stoking the growth even further is the world-beating level of financial confidence among Chinese consumers, especially those in upper income groups. Asked whether they believe their household income will significantly increase in the next five years, 74% of affluent Chinese consumers (that is, those with annual household disposable income above RMB 250,000, or US $40,000) expressed agreement or strong agreement, up from 68% two years ago.

A typical attitude was that of a 30 year-old woman entrepreneur who runs an apparel trading company in Beijing: “I notice the global economic downturn but

### Exhibit 2

**Growth in Mainland China luxury consumption will be driven by very wealthy and middle class consumers**

<table>
<thead>
<tr>
<th>Million, percent</th>
<th>Very wealthy (&gt;1MN)</th>
<th>Wealthy (500K-1MN)</th>
<th>Mass affluent (250-500K)</th>
<th>Upper middle class (50-250K)</th>
</tr>
</thead>
<tbody>
<tr>
<td>&gt; 1MN</td>
<td>256</td>
<td>288</td>
<td>32</td>
<td>36</td>
</tr>
<tr>
<td>500K-1MN</td>
<td>10</td>
<td>13</td>
<td>10</td>
<td>12</td>
</tr>
<tr>
<td>250-500K</td>
<td>90.0</td>
<td>90.7</td>
<td>12</td>
<td>15</td>
</tr>
<tr>
<td>&lt;50K</td>
<td>8.1</td>
<td>6.8</td>
<td>2</td>
<td>2</td>
</tr>
</tbody>
</table>

**Share of urban households by annual household disposable income**

<table>
<thead>
<tr>
<th>Billion RMB1, Percent</th>
<th>Very wealthy (&gt;1MN)</th>
<th>Wealthy (500K-1MN)</th>
<th>Mass affluent (250-500K)</th>
<th>Upper middle class (50-250K)</th>
</tr>
</thead>
<tbody>
<tr>
<td>&gt; 1MN</td>
<td>127</td>
<td>188</td>
<td>14</td>
<td>12</td>
</tr>
<tr>
<td>500K-1MN</td>
<td>36</td>
<td>32</td>
<td>10</td>
<td>7</td>
</tr>
<tr>
<td>250-500K</td>
<td>27</td>
<td>25</td>
<td>13</td>
<td>17</td>
</tr>
<tr>
<td>&lt;50K</td>
<td>12</td>
<td>15</td>
<td>4</td>
<td>4</td>
</tr>
</tbody>
</table>

**Share of luxury consumption2 in China by annual household disposable income**

1. 2012 RMB terms
2. Luxury goods include fashion ready to wear, leather goods/handbags, watches, and fine jewelry

*SOURCE: McKinsey Insights China – Luxury Consumer Study (2012); team analysis*
I don’t think this will impact China,” she told us. “We Chinese are rich and have sufficient savings. This worldwide environment won’t have much impact on us.” Not everybody shares such a firm degree of self-assurance; as worries have mounted in the second half of the year, some luxury shoppers have altered their carefree ways, one example being a Shanghai beauty-store operator who said: “My past purchases included a HK$30,000 watch for a real estate agent who helped me find a prime location for my outlet. As business has slowed, I have cut back to wallets from HK$3,000 to HK$6,000.” Still, Chinese consumers are much more upbeat than Westerners. Among wealthy Americans (defined as those with household disposable incomes above $150,000), only 46% said they expect their incomes to rise substantially in the next five years (see exhibit 3).

Exhibit 3

Despite uncertainties about China’s economic slowdown, the financial confidence of Chinese luxury consumers remains high

<table>
<thead>
<tr>
<th>“I strongly believe my household income will significantly increase in the next 5 years”</th>
<th>Percent of wealthy respondents who agree or strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>China (2010)</td>
<td>68</td>
</tr>
<tr>
<td>China (2012)</td>
<td>74</td>
</tr>
<tr>
<td>United States (2012)</td>
<td>46</td>
</tr>
</tbody>
</table>

1 Consumers with annual household income above RMB 250K
2 Consumers with annual household income above USD 150K


As anyone might guess from the feminine glamour on display in ritzy Chinese neighborhoods, another important source of the growth in the luxury sector is the increasingly high purchasing power of women. Spending by males led luxury consumption several years ago, but outlays by females have risen much faster, and now constitute nearly three-fifths of the market.
Not all purchases of luxury goods by Chinese involve items that they keep for themselves. Indeed, the practice of social gifting has been, and will remain, yet another major reason that the luxury sector is expanding. Some analysts expect this trend to wane because the press – and government investigators – are devoting more scrutiny than ever to powerful people receiving lavish gifts such as watches and jewelry. No doubt, gifting by companies has dropped in response to such attention. But this dip is probably just temporary, and in any case corporate gifting should not be confused with gifting by individuals. The social gifting culture is embedded in Chinese society; it is a faithfully-observed feature of holidays and celebrations because it is seen as a way of nurturing and maintaining relationships – so it is not about to diminish in importance anytime soon. When we asked luxury shoppers what will happen to the proportion of their luxury spending devoted to social gifting in the coming year, 39% said they expect it to increase, 58% said they expect it to remain the same, and only 3% predicted it to decrease. The comments of one Shanghainese woman, whose seven year-old daughter attends a private school, are informative: “On Teachers’ Day (September 10), some parents of my child’s classmates bought teachers bags made by famous designers to make sure their children will be taken extra good care of in school.”

Finally, changing lifestyles are also contributing to the luxury boom. Upper-class Chinese are spending more time with other wealthy friends at social occasions such as fancy dinners and parties, which is giving them new opportunities to show off their collections of clothing, shoes, jewelry, and bags.

The ultra-wealthy: Why they expect more – and why they get it

Treating a customer to a top-class shopping environment is of greatest import when he or she is ultra-wealthy. Defined as households with liquid assets in excess of RMB 100 million, this group is well worth extraordinary efforts to cultivate and pamper. Our consumer survey did not include enough of them to make specific, definitive statements about where their buying habits are headed, but based on interviews with people in the industry and other research, a number of observations can be made.

The ultra-wealthy tend to be private business owners, real estate developers, professional investors, natural resource developers, or high-salaried executives (or such peoples’ spouses or children). More and
more, they are behaving like their counterparts in developed countries, viewing luxury as a way of life and showing fondness for products that are exclusive, such as Chinese classical art or fine wine. Accordingly, they like to buy limited-edition or made-to-order luxury products, even ones costing tens of thousands of dollars. Indeed, for some of them, the more expensive a product is the more impressive they may view it.

With few exceptions, ultra-wealthy consumers expect individualized, VIP treatment from luxury brands. This may include dedicating a sales professional to each ultra-wealthy customer, closing an entire floor for them to browse or giving them a private shopping area. If they appreciate the service, they often take care they are buying enough to stay on a brand’s VIP list. As one store manager of a high-end luxury brand confided: “When they’re invited to exclusive events, most if not all of our VIPs make purchases, and if they have to cancel at the last minute, they will buy other products in the store to make sure they keep their VIP status”.

A typical example of how brands accommodate such shoppers is the intimate service Chanel used to win the favor of a 33 year-old Shanghai housewife. This woman, who comes from an ultra-wealthy household, received a phone call from her dedicated sales representative at Chanel, notifying her of some new product arrivals that seemed likely to appeal to her well-developed fashion sense. When she arrived at the Chanel store in the Peninsula Hotel – which targets the super-rich with its low traffic and abundance of salespeople – her sales rep took her to a VIP room while other store personnel took care of her young son. Desserts with the Chanel logo, ordered from the hotel bakery, were served to her as she examined the specially-selected products. She left with 2 Chanel bags and one dress.

Catering to these consumers’ whims does not end during their store visits, of course. Maintaining their loyalty requires well-crafted customer relationship management programs, which include intensive efforts to understand individual consumers’ preference, conveying information to them about new products they are most likely to fancy, and rewarding their patronage with special perks. In China, some brands have flown their best customers on all-expense-paid trips to enjoy fashion shows, art shows, and cruises; for “VVIPs”, these excursions can involve destinations as far away as Paris.
The transformation of Chinese luxury consumption
In view of the reasons mentioned above for the explosive growth in China’s luxury-goods market, it might seem as if the only worry the world’s famous brands will encounter there is how to make their cash registers work fast enough to ring up all the sales. However, powerful currents of change in this market are making it harder and more expensive to win over the Chinese consumer than ever before.

**China’s globetrotting shoppers**

As they travel more, the Chinese are making a rapidly-growing share of their luxury purchases on trips outside the Mainland. In 2010, only 36% of luxury shoppers made at least some of their purchases of luxury goods while abroad, but in 2012, that share has mounted to 63% (see exhibit 4). To be sure, much of this “overseas” shopping takes place in Hong Kong and Macau. But Europe is growing in appeal among Chinese luxury consumers, with about one-fifth of them reporting this year that their most recent overseas purchases occurred in a European city. That is more than double the European share two years ago.

**Exhibit 4**

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**Share of luxury shoppers by type of shoppers**

<table>
<thead>
<tr>
<th>Type of Shoppers</th>
<th>2010</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shoppers who buy luxury products in <strong>Mainland China</strong> ONLY</td>
<td>65</td>
<td>38</td>
</tr>
<tr>
<td>Shoppers who buy luxury products in <strong>BOTH Mainland China AND overseas</strong></td>
<td>27</td>
<td>50</td>
</tr>
<tr>
<td>Shoppers who buy luxury products <strong>overseas ONLY</strong></td>
<td>9</td>
<td>13</td>
</tr>
</tbody>
</table>

One major factor behind this trend is the rising amount of international travel that Chinese are taking, which in turn is attributable to their higher incomes, the greater ease with which they can obtain visas, and the appreciation of the renminbi against other currencies.

The Chinese made 70 million outbound trips in 2011, up from 57 million such trips in 2010, and by 2015 the number will swell to an estimated 94 million. Among overseas travelers whom we surveyed this year, nearly three-quarters reported that they bought a luxury product while traveling sometime in the past 12 months, up from 45% who said so in 2010. By huge margins, those who shop in foreign countries express positive feelings about the experience. More than four-fifths of them said stores overseas exceeded their expectations in price competitiveness as well as the breadth and newness of the product selection. Nearly as great a majority reported being favorably impressed by the certainty they felt about brand authenticity, and approximately seven in ten said the same about the attitude and professionalism of the sales staff.

The financial motive to buy abroad is strong, mainly because taxes on luxury goods in China range around 20%-70%, depending on the category. The resulting disparities in retail prices can be stunning, especially after accounting for the exchange rate factor. Now that the euro has fallen against the renminbi, some of the most sought-after bags costing several thousand dollars in China can be purchased for about 40% less in Paris.

With so many Chinese visiting elegant stores on their travels, luxury brands must try to provide consistent positioning in their outlets around the world, and keep Chinese speakers on staff. They must also maintain awareness of trends in China, and align the merchandise with what is available in their Chinese stores, even when partnering with prominent department stores, so that they reinforce their brand messages.

Luxury-goods makers face an additional complexity: major changes may be coming in China’s current tax laws. Although government officials have expressed conflicting views, some appear to strongly support a reduction in duties to stimulate domestic consumption. Companies themselves are eager to see the price gap shrink, as they have invested heavily in store expansion in China, and it is naturally easiest to serve Chinese in their home market. Recently
some brands have increased prices only outside of Asia, partly to reflect the recent weakness of the euro and dollar against the renminbi. In Europe, these price hikes are as much as 8% to 10%.

But the price gap is unlikely to disappear. The Chinese government needs to show its commitment to reduce disparities among income classes, and any reduction in taxes is almost certain to be gradual.

Based on responses to our survey, a reduction in price gaps to 20% or below would lead three-fifths of Chinese shoppers who currently buy luxury abroad to buy luxury goods at home. For now, there is a long way to go before the gap has shrunk that far. “Price is a big obstacle to luxury shopping in China,” a man who owns a Beijing patent application agency told us. “For a RMB 10,000 handbag, for instance, I can accept at most a RMB 2,000-3,000 price gap. Otherwise, I am willing to fly to Hong Kong to get it.”

Even if the price gap were to shrink to minimal levels, many Chinese would continue to do at least some of their shopping for luxury products in overseas stores. Journeys abroad are becoming one of the most popular leisure activities for Chinese as their living standards improve, and China’s extended “Golden Week” holidays – there are two each year – make it more feasible to travel long distances. Bringing home gifts for friends and relatives is almost obligatory for someone returning from a trip, and in any case, shopping is a common pastime for Chinese consumers, whether on tour or at home.

Only a small percentage of Chinese luxury shoppers – slightly more than one-tenth – buy exclusively abroad. The majority of them make purchases both overseas and in domestic stores. They account for a rapidly-growing share of Chinese luxury consumption – more than three-fifths, our survey responses show.

These shoppers, buying both in China and abroad, are typically trend setters and fashion innovators. Three fifths of them are women; at least half are young (below 35), have household disposable incomes in excess of RMB 500,000, and have been buying luxury items for five years or more. More so than luxury consumers who shop only abroad or only at home, these shoppers say they are often asked for their opinions about fashion products, and like to discover
new labels and styles before others do. Since they tend to prefer western styles in their luxury products – only 20% of them said they strongly prefer products with Chinese influence – brands are unlikely to see a big swing for Chinese-influenced designs any time soon. To win over these shoppers, luxury-goods companies need to insure that they serve them with strong customer relationship management (CRM) programs. In our survey, more than two-thirds of these shoppers said they want to receive the latest information on new products or promotions in China, even if they don’t buy in China.

**Gaining sophistication, with impressive speed**

Just as China is developing, growing and modernizing at astonishing speed, so the tastes of many Chinese luxury consumers are maturing with unexpected rapidity. People with upper-level incomes, who until recently were adorning themselves with loads of logos, are becoming more sophisticated after just a few years’ experience as buyers of luxury products (see exhibit 5). Asked whether they prefer luxury items that are “low-key and understated,” two-thirds of the respondents to our 2012 survey agreed or strongly agreed, up from one-half two years ago. The share of respondents agreeing or strongly agreeing that “showing off luxury goods is in bad taste” was 51% – the same as Japan, and a big jump from the 37% who said so in 2010. One woman who works as assistant manager of a Beijing high-tech company explained her inclination thusly: “I don’t like bags that are full of flashy logos. I prefer something with good quality and a tiny logo on the top.”

Unsurprisingly, it is the tenured shoppers – whom we define as those who bought their first luxury products more than ten years ago – who are most likely to favor subtlety and gain emotional satisfaction from differentiated products that reflect their individual tastes. Tenured shoppers are much more likely than new entrants (those who bought their first luxury item less than two years ago) to agree that their reason for buying luxury “has nothing to do with showing off.” And 49% of tenured shoppers say they like to discover new brands and styles before others do, compared with only 31% of new entrants who say so. This may bode poorly for brands that have been clear market leaders and shapers in past years; they now face the problem that their fame and omnipresence cause many consumers to seek rival labels. Fortunately for these brands, people who have just joined the ranks of luxury shoppers – a
Chinese luxury consumers are increasingly looking for less flashy and more understated products

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<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>&quot;I prefer luxury items that are low-key and understated&quot;</td>
<td>50</td>
<td>66</td>
</tr>
<tr>
<td>&quot;I feel that showing off luxury goods is in bad taste&quot;</td>
<td>37</td>
<td>51</td>
</tr>
</tbody>
</table>
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The more the market splinters in these ways, the harder it may become for brands to maintain strong legitimacy as they try to serve a broader buyer base. Those who try to satisfy everyone risk straying from their core strengths and heritage. That could dilute the exclusive image that gave them their desirability in the first place. But focusing on new entrants is also a dangerous approach, as they may follow the sophisticated market trendsetters more quickly than expected.

**The battleground for luxury shoppers: The store**

An exceptionally important touch point for Chinese consumers as they make decisions about buying luxury products is the experience they have in a store. When we asked luxury shoppers which factor tended to be the most influential
in driving their purchases, more than half cited some aspect of the in-store experience – their evaluation of products they bought in the store, conversations they had with store salespeople, the notice they took of products in store windows, demonstrations of products they saw in a store, or their perusal of an in-store catalog or video display.

One other phenomenon makes the in-store experience increasingly critical in the luxury segment: the growing frequency of buying on impulse or after very brief consideration. Not only are stores where Chinese consumers tend to learn the most about luxury brands and form their preferences; more often than before, a good in-store experience can lead to on-the-spot purchases. Among respondents to our survey who bought bags, purses or wallets the last time they went shopping for luxury goods, 37% said they bought the item in question within one day of first wanting to buy, compared with 24% who said so in 2010. For those who had bought ready-to-wear luxury apparel, 39% said it was an impulse decision, up from 29% who gave similar responses two years ago (see exhibit 6).

And the longer consumers shop for luxury, the more they care about the stores they patronize. Among those who have bought luxury products for more than five years, 52% said they prefer stores that are “large, with very grand decoration”, compared to 42% of those with less than five years of luxury shopping experience. Luxury goods makers are responding accordingly. The size of Chinese stores purveying luxury brands has increased dramatically in recent years – for some brands, a three to five-fold expansion of space in the average outlet since 2007. Such strategies may be extremely costly in light of the 5% to 7% annual rise in rents for prime retail space that has taken place in the past two years, along with 10% to 15% annual increases in wages for well-trained store employees. But it makes sense for companies to expand store sizes and put their flagship stores in China’s top cities, focusing on key malls where luxury brands cluster and rich consumers flock – even if that comes at the expense of a wider footprint in other cities.

Luxury shopping online: Still testing the waters

For consumer goods in general, the share of shopping conducted online is bigger in China than in the United States, with especially explosive growth
coming in apparel and electronics. But in luxury, the progress could best be described as incremental. A small but growing number of Chinese shoppers are venturing online to make luxury purchases, and a much larger group is using the Internet to browse. Among respondents to our survey, online spenders – people who made purchases of luxury items at least once online in the past year – rose from 2% in 2010 to 8% in 2012, and the amount they spent increased from 1% of total luxury spending to 3% (see exhibit 7). More than two-fifths said they had gone online to gather information in connection with their last purchase.

With all the counterfeiting of luxury goods for which China is notorious, it is understandable that the Chinese themselves are wary about buying such products online. Three-quarters of those who have shunned the Internet as a channel for making luxury purchases cited concern about fake products as one of their top reasons.

For those who engage in it, online shopping is a form of arbitrage to seek price

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**Exhibit 6**

<table>
<thead>
<tr>
<th>Bags, purses, wallets</th>
<th>Ready to wear</th>
<th>Watches</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Percent</strong></td>
<td><strong>Percent</strong></td>
<td><strong>Percent</strong></td>
</tr>
<tr>
<td>More than 1 month</td>
<td>27</td>
<td>8</td>
</tr>
<tr>
<td>1-4 weeks</td>
<td>26</td>
<td>22</td>
</tr>
<tr>
<td>2-6 days</td>
<td>23</td>
<td>31</td>
</tr>
<tr>
<td>Within 1 day</td>
<td>24</td>
<td>39</td>
</tr>
</tbody>
</table>

levels comparable to those overseas. Consumers who bought online reported saving an average 32% on bags, 58% on suits, 36% on shoes, 37% on jewelry, and 47% on watches. Overwhelmingly, they made purchases on websites such as Taobao.com and ihaveu.com; official manufacturer’s websites garnered only 4% of online purchases. The online shopping experience almost invariably involves viewing of editorial comments by other users, celebrities and famous bloggers, which may heavily influence consumer behavior right at the point of the purchasing decision.

Luxury players are conducting their own tentative forays into the channel. Burberry started its own e-commerce site in China in March 2011, and Armani Group also launched such a site, operated by Yoox, last year. Still others are sticking to editorial platforms to promote their wares indirectly, an example being nowness.com, a site created by LVMH, which posts stories and articles about fashion, art, travel and gastronomy. The firm launched a Chinese version of the site (the only other language besides English) this year.
But online purchasing isn’t about to displace in-store shopping for luxury goods in China anytime in the foreseeable future – especially not when it comes to the country’s wealthiest people.
Winning over Chinese luxury shoppers
What are the implications of the above findings for purveyors of luxury goods? Following are the main take-aways for success in this market.

**Focus on your core and build on your heritage:** Achieving growth while remaining exclusive, and appealing to more consumers without losing cachet, may be a tougher balancing act in China than in any other market, according to some top executives in the luxury-goods sector. Even as new entrants flock to a popular brand, the loyalty of more tenured consumers may weaken because they are seeking to differentiate themselves and achieve a sense of specialness with a smaller, niche product. In the worst case, new entrants may even follow the trend set by tenured consumers into alternative products—leaving the once-fashionable brand abandoned by both ends of the market.

Now that Chinese luxury shoppers have become more sophisticated, and can sense when a brand is trying to be everything to everyone, brands must focus on their core strengths. A brand needs to continue building on its heritage—highlighting the skill of its craftsmen, for example, or the length of its history—to strengthen the brand’s appeal. This does not mean that brands should completely avoid expanding into new categories; rather, they should do so in a way that enhances their key narrative. Thus a leather goods firm may readily benefit from adding accessories to its product portfolio, but expanding into watches and jewelry might confuse consumers unless such an expansion relates to the firm’s core products. Advertising should be used to drive core brand equity with a single message focused on iconic categories and products rather than spreading marketing investment across all categories. And the core product category must include sufficient variety and novelty to allow consumers to trade up.

**Set prices based on a strategy that is coherent with branding, merchandising, and global image:** Price is a major signal in China. It drives perception of worth, and products that drive aspiration should not go on discount. Assuring consumers that everyone pays full price will bolster a brand’s prestige. This is particularly true for iconic products—those aimed at brand building—for which prices should remain fixed, though for other items companies may need to adjust price levels so that inventories do not rise excessively. Wide gaps between domestic Chinese prices and overseas prices may lead customers to delay purchases, so a balance should be struck to keep
domestic prices at reasonable levels relative to those abroad. And for some brands that are trying to broaden their reach as they develop new channels of distribution, such as outlet stores or web sites, there may be opportunities to attract more price-driven market segments and move some goods at lower prices. To the extent promotions are offered, they should be limited to VIPs – either making the process fully transparent or eliminating promotions altogether. In general, iconic categories and products that never go on sale should be kept distinct from those that might.

**Strike the right balance between store numbers and quality:** Having increased their numbers of stores at a very fast clip in recent years, most luxury goods makers should now seek optimality in their footprint coverage and bolster the productivity of their existing stores. Some brands have traded off their store locations and sizes to achieve maximum expansion, and opening a store in a non-exclusive location can actually hurt brand image. It is therefore advisable to refurbish and upgrade current outlets, with the aim of ensuring that sites are prominent and stores globally consistent in terms of look and feel. Expanding selectively in a few untapped lower-tier cities may be desirable. Successful brands are in the process of adopting this approach; some told us they are planning to slow down expansion and perform better in their core Tier 1 city locations. For example, one leading luxury brand has opened its largest store in China, at over 1,200 square meters, situated in one of Beijing’s ritziest malls.

**Serve China’s globetrotting shoppers:** Maintaining a consistent image in stores and products in all countries is especially essential now that Chinese travelers are becoming so ubiquitous. Retail locations should be chosen for maximum appeal to Chinese tourists, and Chinese-speaking sales representatives should be available at such outlets. Travel retail outlets, such as duty-free airport boutiques, are of growing importance for reaching Chinese shoppers, so brands should ensure that they also staff those stores with properly-trained salespeople and provide Chinese-oriented merchandise. Trends showing the most popular foreign destinations for Chinese merit careful monitoring, now that more Chinese are traveling to places such as nearby Asian countries or Europe rather than just Hong Kong and Macau. CRM programs should be globally-oriented, not just focused on China, though privacy regulations in some countries may make it difficult to manage
fully-global customer databases. More broadly, companies’ organizational structures should reflect the importance of the Chinese market by including clear processes for generating direct communication between headquarters and local operations in China, the aim being to allow instant feedback on the market’s latest developments and trends.

**Build CRM excellence:** This means wholeheartedly embracing and implementing CRM programs. At the heart of these programs is technology—the use of data, from online and offline consumer transactions, social media, marketing campaigns, and call centers—enabling retailers to improve the effectiveness and efficiency of their marketing and merchandising capabilities. The growth in transaction databases, and popularity of social media, makes it possible for companies to collect data with greater granularity and volume than ever. But in luxury in particular, brands should fit their CRM programs to surprise and impress their customers with personalized and exclusive offerings. Once they have gained a more granular understanding of their customers, they can better engage with them. Starting small, with a few initiatives offering high-impact pampering, is often the best way to go.

**Embrace the online opportunity:** Most luxury companies have shied away from online channels, fearing that e-commerce might tarnish brand equity and assuming that Chinese would never buy expensive items that way. Although this assumption may still be valid for now, it is likely to change. In the long run, online purchasing will be about more than just educating and engaging luxury consumers. Even if the in-store experience remains paramount, consumers’ decisions will be increasingly influenced by what they see online.

For luxury brands to make inroads into e-commerce in China, it is critical to understand key characteristics of the country’s online shoppers. Social shopping—viewing editorial comments from other users and celebrities—is especially prevalent when Chinese consumers venture online. At the same time, Chinese shoppers have deep concerns about product authenticity and payment security. With those issues in mind, luxury goods makers should begin tailoring e-commerce operations to be ready if and when the channel takes off. For those wishing to start slow, sensible possibilities include managing a prestige online presence through password-protected websites for select groups of registered customers. Most brands have significantly improved their digital marketing
capabilities to provide information that consumers are searching for online, as well as to generate positive buzz on social media sites. The savviest brands are also finding ways to drive offline and online sales via collecting information from consumers to feed into their CRM database to fine-tune product and service offerings.

Cater to the ultra-wealthy: Tailor-made and understated products appeal most to ultra-wealthy consumers, so winning their favor requires customizing brand and product portfolios accordingly, using limited-edition offerings to create an aura of exclusivity. For these consumers, the bar for a good CRM program should be significantly higher than usual, with their preferences and general profiles a matter of deep familiarity to store managers. Dedicated sales teams should proactively cultivate relationships with the ultra-wealthy, providing them with personalized touch points along their decision journeys. In Europe, the service mode for big customers tends to be more functional – providing them with fashion advisers, for instance, or giving them special access to the latest styles. But super-rich Chinese consumers love, and count upon, “over-the-top” VIP treatment. Stores’ selling approach and service modes must fulfill the expectations of such well-heeled shoppers for exclusivity and privacy, such as providing private shopping areas. And brands should not hesitate to pamper these consumers, entertaining them with fashion shows and other such exclusive and memorable events.

Successfully implementing the above strategies will be neither easy nor cheap. But for luxury companies, it is imperative to address the challenges outlined in this report – the globalization of Chinese luxury shopping, the rising sophistication of the country’s consumers, and the changing ways in which those consumers make purchases. Even if the market is slowing, the outlook is robust, and there is no denying that the Chinese have become the world’s most important luxury buyers. The firms serving that market will need to adapt accordingly.
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McKinsey Insights China provides businesses with the data, analytics and rapid, customized problem-solving and decision-making support to help build robust strategies for China’s rapidly changing marketplace. The data and analysis combine results from McKinsey’s annual Chinese consumer studies with proprietary macroeconomic and demographic data and analysis from the McKinsey Global Institute (MGI).

McKinsey Insights China updates the macroeconomic models regularly – the national model every six months and city level model annually to retain the most recent view of the Chinese market at a highly granular level. These frequent updates ensure that the latest economic activities and policy changes are reflected in our forecasts of demographic, economic and consumption variables at the individual city level.

Since 2005, we have conducted the largest study of Chinese consumers on an annual basis. We have interviewed more than 70,000 Chinese consumers across over 60 cities, giving us a deep understanding of Chinese consumers’ attitudes and spending behavior in more than 100 product categories. The respondents come from a wide range of incomes, ages, regions, city-clusters and city-tiers, and represent 74 percent of China’s total GDP and 47 percent of the total population.

Since 2008, we conducted 3 additional studies of over 4,200 luxury spenders and wealthy consumers with annual household incomes in excess of RMB 250,000, giving us unprecedented insight into the behavior of this fast expanding and economically important segment.

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