



Quan Zhou

Luxury Market in China

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Author	Quan Zhou
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Instructor	Keaney Michael

Abstract:

With the rapid development of China's economy, the level of capital income is expanding significantly. The size of the rich population in China is becoming larger than ever. At the same time, the luxury market of China is also showing great vitality. There is no doubt that China is already the luxury market with the most growth potential. With increasing numbers of high-end consumer goods now being sold, the consumption gap between China and the world is being gradually shortened. And Chinese society has come to advocate a new consumption concept. "Luxury" does not mean corruption, waste, decadence, and unfairness. Rather, it means the awakening of people's self-awareness. Luxury and its consumption have become a driving force for social progress and economic development. The rapid economic growth of China has spawned a massive high spending market in this situation, and Chinese consumers' purchasing power is surprising the whole world. At present, the scale of the high-income group continues to grow. Thanks to increased income levels, the demand for luxury goods is also increasing intensely. Being faced with such a market situation, this thesis lays emphasis on analysing the current situation of the luxury market in China, combining research on Chinese consumers' behaviours and how Chinese culture influences the marketing of luxury products. This research is intended to apply useful and practical information for any individual interested in the Chinese luxury market for investment or study purposes.

KEY words: China; luxury market; Chinese consumer

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1 A Brief Overview of Luxury and the Chinese Luxury Goods Market, Including Definition, Types, and Related Brands.

1.1 The concept of luxury

The globally accepted definition of luxury goods is that they are unnecessary consumables, surpassing the demand of people's basic living, which are expensive or hard to obtain. From the perspective of economics, luxury refers to the products with the highest ratio of value to product quality. From another angle, luxury is related to the ratio of intangible value and the tangible value. The concept of luxury is continuously evolving. So in different times, there are diverse representative luxuries. (Guan Jun, Xiao Zishi, 2007. *Luxury consume Behavior in China. Market Modernization. (04):157-159*)

As far as the luxury industry is concerned, the luxury sector actually is an elite industry, which mostly represents the people pursuing a high-quality way of living. When enjoying luxuries, we at the same time seek a qualitatively better life. The top consumer goods are always connected with a successful brand, excellent product quality, outstanding design concept, and even the accumulated history and cultural inheritance. Among all these factors, exorbitant price is the least considered element. That is to say, luxuries may not be the most expensive, and in the other way round, the expensive products may not be luxuries. Looking from a deeper level, luxury is a kind of lifestyle.

1.2 Superlative level products

1. Excellent quality

Luxury can often be the leader of fashion with its unique visual expression to overcome the barrier of languages and words, which can also give consumers pleasant aesthetic enjoyment. The design is classical and elegant. The workmanship is excellent, thus the quality is extraordinary.

2. Scarcity

Because of its scarcity in these aspects of nature, technology, limited production and so on, very few people can possess luxuries, which gives exalted peculiarity to the possessors.

3. Exorbitant price

The exorbitant price is a synonym for excellent quality in most cases. In this price the luxury goods can be only owned by very few people.

4. Profound cultural foundation

Luxury is steeped in deep cultural connotation with its particular operational philosophy, legendary management process, historical challenges and other favorable factors, which all work to enhance its appreciation.

5. Non-essentials

What is valued most is luxury's ability to satisfy people's non-material desires rather than the value in use. This applies to many product categories, including fashionable dress ware and leather products, yachts, cars and motor bicycles, jewelry and watches, pens, perfumes and cosmetics, fine wines, furniture and home textiles, kitchen ware, dinner ware, porcelain, object-oriented design, luxury hotels, mobile phones and computers, and so on.

1.3 Examples of luxury brands:

There are ten brands of fashionable dress. Donna Karan, Louis Vuitton, Chanel, Versace, Dior, Gucci, Valentino Garavani, Prada, Guess, and Giorgio Armani are all very expensive. What is more, when it comes to perfume, people just cannot help talking about famous brands, for example Chanel, Estee Lauder, Lancome, Calvin Klein, Gucci, Dior, Elizabeth Arden, Davidoff, Guerlain, Polo Ralph Lauren and so on. The older the brands of high class perfume are, the better the quality. A time honored brand possesses an historical legacy that is invaluable.

2 A Brief Introduction to China's Economy

2.1 The constitution of China's economy

Agriculture is the foundation of China's economy. It is the major source of light industry's raw materials, providing a broad market for the secondary and tertiary industries. Besides, agriculture is the significant source of accumulation of national construction funds and exports.

Moreover, agriculture is necessary to support the development and improvement of the entire national economy. With the evolution of social division and production socialization, the structure of national economy is constantly changing. In modern states, agriculture is foundational and industry plays the leading part in the national economy, and these two domains' development also promotes the transportation and construction business, then Commerce and services, which appears in national economy in larger and larger amounts.

Although agriculture is the foundation of China's economy, manufacturing industry, which is also called the secondary sector, occupies the largest share of China's GDP, 46.8% in 2010 (Intranet Business Express 2010).

The service sector (also called the third sector) is the fastest growing sector in China, which is also the area in which the Chinese government encourages investment. The proportion of this industry is one of the benchmarks to evaluate a nation's development level. Most developed countries have a very mature service industry; in China the third sector is relatively weaker than many countries. Recent policy of China indicates that this industry may have a bright future in China, because the Chinese government has noticed its importance, and it has made great efforts to stimulate its development.

2.2 The changes within the Chinese market, social structure and the rich

With the establishment and incessant expansion of the reform and opening-up policy, Chinese economic strength has undergone unprecedented changes, as it gradually integrates into the world market. The economic globalization is a driving force for national economic development and consequently unprecedented challenges.

China has the largest population in the world. According to the data of the sixth census (conducted in 2010), the population of China has reached 1.37 billion. China's Gross Domestic Product (GDP) is now the second largest in the world, only after that of the United States of America. However, the gap between poor and rich in China has grown significantly. China's Gini coefficient has changed from 0.28 to 0.48 from 1978 to 2007, and some estimate that it has surpassed 0.5 in recent years, although the official figure shows that it was below 0.5. This suggests that most of the nation's wealth is owned by very few people. According to the World Bank, in China 1% of families own 41.4% of the wealth of China (World Bank, 2007). The per capita income of families living in China's urban areas is 19109.44 Yuan (about 2158 Euro) in 2010 (China Yearbook, 2010). According to a report by Hurun in April 2011, the number of Chinese multimillionaires has grown to 960 000, and the number of people owning more than 100 million Yuan (about 11.427 Million Euro) reached 60 000. (Hurun Corp, 2011)

Due to the high-speed development of the economy, as well as the rapid increase of the rich population, luxury markets in China are also expanding greatly. After becoming a member of the World Trade Organization in 2002, China is taking an active part in cooperating with other countries in economic and trade matters. Compared with 10 years ago, nowadays the number of foreign brands in the Chinese market has increased on a massive scale. With the gradual opening up of Chinese market policy, international brands flood into this huge profitable market. For years those foreign brands wanted to explore in the market, but they were restricted from the Chinese market by many different protection policy measures. With the loosening of restraints in the Chinese market, they arrived falling over one another. Among those foreign brands, luxury brands are in the spotlight. For the sake of fashion, facial appearance, display or other factors, rich Chinese consumers buy luxury goods with an enthusiasm that shocks the world.

3 Analysis of Chinese Consumers

3.1 Who buys luxury? Chinese affluent consumers

From a historical perspective, Hedrick-Wong (2007, p. 37-40) describes broadly China's four generations:

1. Founding generation: aged 70 years and older. This generation was at least 40 years old in 1978 when China began its reform and opening-up policy.
2. Cultural Revolution generation: aged between 50 and 65 years old. Some of this generation was lucky to continue their interrupted education, or have the contacts and resources to start business; for them the 1980s and 1990s represented many great opportunities. Many caught these opportunities and a lot of China's entrepreneurial pioneers came from this generation.
3. Upwardly mobile generation aged from 30 to 49 years old. The members of this generation were in the early 20s when the 1978 reforms started. They were the first generation to benefit from them. The elite of modern China mostly come from this generation. They have better education opportunities than the previous generations and more opportunity than the subsequent generation, especially for those who have a university degree.
4. Young emperor generation refers to those born after the 'one child' policy which was introduced in 1979, that is the post-80s as well as post-90s and the even younger. They were called the 'young emperors' because they grew up with being spoiled much more than ever. And this generation is characterized by self-centeredness or even self-indulgence.

From the information above we believe that the latter three generations have the motivation and the ability to buy luxury products. More specifically we have classified three groups as the main consumers of luxury products in Chinese market.

3.1.1 The rich population

We assume that this group of people makes money by their hard work. They have very successful achievement in their career. They are defined as people who earn more than US\$25,000 per year. That is to say that many rich people do not belong to this group, although they have assets of high net value for example, the second rich generation. Table 1 shows some features of the rich population:

Table 1. Features of the rich population

Age		Gender		Education		Overseas experience of living or working	
Below 30	22%	Male	76%	Below high school	1%	Yes	46%
31-46	64%	Female	24%	High school	5%	No	54%
Above 46	14%			College	11%		
				Bachelor's degree	50%		
				Above Master's	33%		
Total	100%		100%		100%		100%

Source: MasterCard & HSBC, report of rich people study, 2007

We can conclude the main feature of this group: young (86% less than 47 years old), well-educated (83%), more than half have overseas experience of living or working. We can deduce that most of this group belongs to the upwardly mobile generation.

There is plenty of evidence which suggests the appeal of luxury goods to this group. This group has particular taste in fashion, an international background, and most importantly they are young. Besides, nearly half of them occupy a high position at their work, and for the sake of status they need luxury goods too. So the people in this group are consistent with the largest part of Chinese affluent consumers. The researches of others also support this idea. (Hendrick-Wong 2007)

Figures 1 and 2 shows the results of Hendrick-Wong's study of China's affluent consumers.

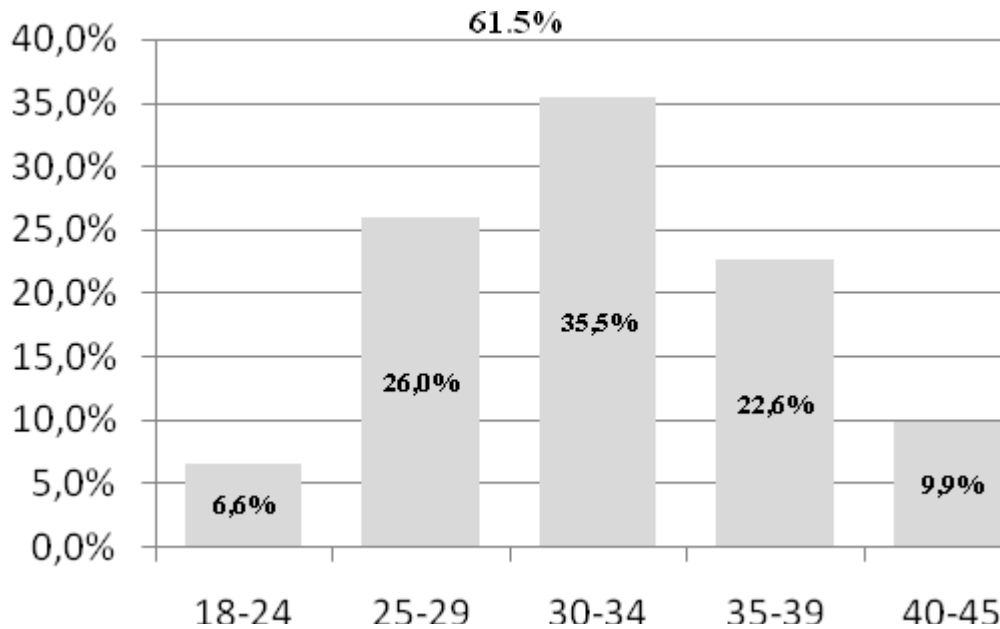


Figure 1: Age of affluent Chinese consumers (Hedrick-Wong 2007, p. 48)

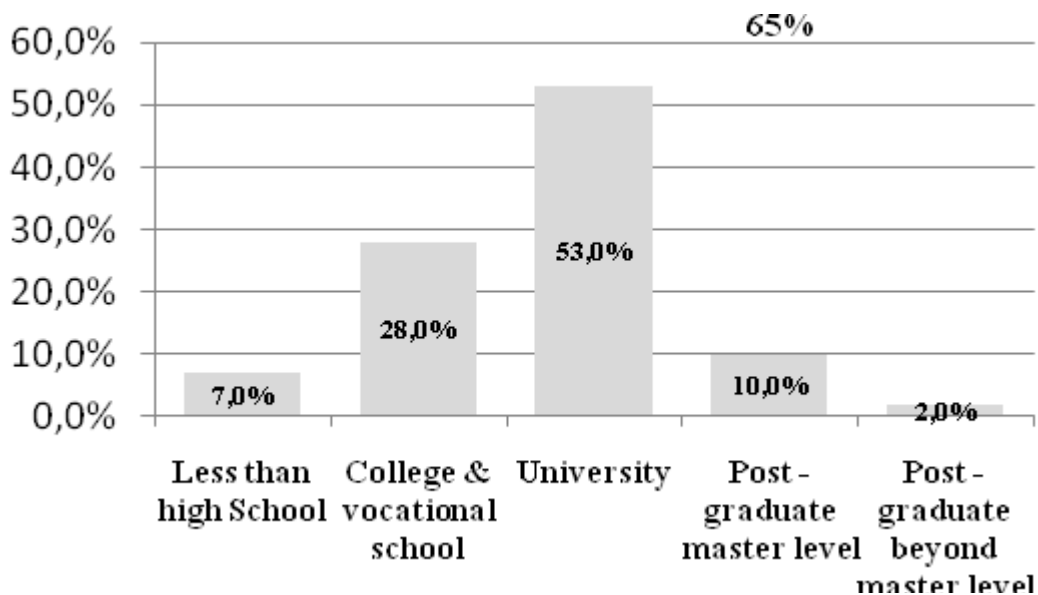


Figure 2: Age of affluent Chinese consumers (Hedrick-Wong 2007, p. 48)

3.1.2 The second rich generation

This phrase appeared in a TV talk show called "a date with Lu Yu" for the first time. In this program the second rich generation is defined as "children of the magnate, born in the 1980s, inheriting billions of families' wealth." More specifically, the second rich generation refers to the children of the "first rich generation" which took advantage of the reform and

opening-up policy and became very wealthy.

This group is poorly regarded in China's society. In many cases they do not even have a job that pays them decently, but they own or will own a lot of wealth: from their parents. The second rich generation is characterized by fashion-seeking, free-spending, and not as thrifty as their parents. And like most born during the 1980s, they are spoiled in terms of both material and spiritual conditions. This rich generation is always very young, because most of them are the children of the Cultural Revolution generation which abounds with entrepreneurs.

So it is easy to explain why in Figure 1 there are 6.6% of affluent consumers aged 18-24, and a relatively high 26% of them aged 25-30. Most of those people have just started their career life; some are even still on the campus. Without the supports from their family, they might be struggling to pay for their house debt. But for the second rich generation they do not have to consider those. Surely they have their own house, possibly even more than one. So what they desire are luxury goods, from head to toe.

3.1.3 Middle class

As we can see in Figure 3, the consumers of different luxury goods can be divided into separate social groups.



Figure 3. From necessities to luxury goods. (Zheng Hong'e, 2010)

In the second level in the pyramid, the middle class buys the new luxury goods. Michael J. Silverstein *et al* (2005:30) define new luxury goods as a category of products or services which is better than the similar species in the market in terms of quality and taste, and which also wins the hearts of consumers. Those goods cost a lot of money, but are not so expensive that many people could not afford them.

New luxury goods fill the niche between top luxury goods and common goods. With better quality than common goods and lower price than top luxury goods, they satisfy more consumers' demand for luxury goods.

A report from the Chinese Academy of Social Sciences (2010) insists that in China the middle class are the families who earn more than 75,000 Yuan a month (about 8000 Euro). This figure is criticized by many people because it's extraordinarily low. Some declare that the ones who earn US\$10,000 to US\$50,000 annually, own at least a house and a car should be considered as middle class; some believe that the standard is too high or too low. In this report we define as middle class individuals who have annual income between US\$10,000 and US\$50,000. The ages of Chinese middle class are scattered, but they have some common points: fixed income, relatively good financial conditions, as well as the

anxiety about their place in the social structure-----middle class is the most unstable class in society. Unlike European countries or the USA, the middle class occupies rather little proportion in China's society. So another group of people raises our attention: those people who save money for luxury purchases.

3.1.4 Common people

Low income consumers have annual income less than the middle class, but even more desire for luxury goods. Most of them have just started their career and have little savings (some even rely on their parents' help from time to time). Basically this group of people is the young emperor generation. It is this group that makes the Chinese luxury market quite different from the other countries. The unique phenomenon in China is that the very rich people of China mentioned above buy only 30% of the total amount of luxury goods, while those who have lower incomes purchase the remaining 70%. The common consumer, typically white collar workers usually spend several months' salaries for a luxury product. They save money for luxury goods, and their behavior is classified as "luxurious consumption". (Yang Lin, Wang Wei, 2010)

Some researchers call them "the new generation of luxury consumers". These consumers are mostly young white collars in metropolitan areas of big cities, featured as "young, sensitive to fashion and luxury brands as well as the information about the world's popular consumer trends. But because they are not rich enough to meet their demand for luxuries, most of them focus on the primary level of luxury consumption which means that the luxury goods or service which cost relatively few money or more affordable, such as cosmetics, perfumes, handbags and so on. (Yang Lin, Wang Wei 2010)

Another phenomenon raises the world's attention: more and more Chinese people flood into the department stores to shop for luxury goods when they travel abroad. Chinese tourists are pouring money in the foreign luxury market. At first the sales staff were very astonished by the crazy consumer behavior of the Chinese, then they were acquainted with the reason: that is because there are buyers in the foreign luxury shops for the Chinese consumers, there are different kind of people: their friends, relatives, colleagues etc. The price of luxury goods is much lower in other countries or Hong Kong, so the Chinese tourists abroad are always delegated by many acquaintances to buy luxury goods for them. Unlike the local consumers, Chinese buyers for luxury goods abroad do not compare a lot between the

products: They always know clearly which one is the one that they are asked to buy. Antoine Colonna (2004) pointed out that in 2004, there were 25 000 000 Chinese tourists who traveled abroad, and this number will increase to over 100 000 000 in 2020. The average expenditure is \$1,000 per time for each Chinese tourist traveling abroad. The potential of the overseas market is enormous. It is said that more than 30% of the luxury goods in Galeries Lafayette luxury department store in Paris are bought by Chinese tourists. (Chen Qingchun, 2011/02/05-2011/02/20. *Luxury Goods Online. IT Managers World. 309 (310)*)

3.2 The purposes of buying luxury goods.

In this part I divide the purpose of buying luxury goods into two categories: as gifts and for personal use.

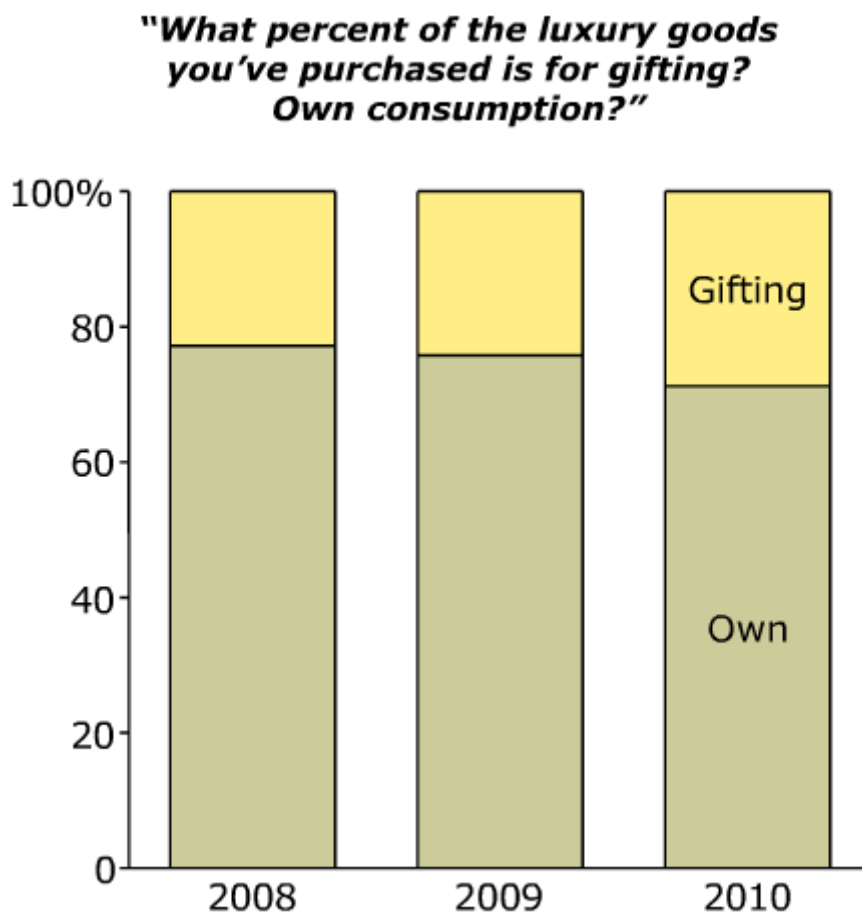


Figure 4: The percentage of use of luxury goods in China

Source: Bain survey of luxury goods consumers in Mainland China 2010 (n=1,471), brand

interviews

3.2.1 Luxuries for gifts.

China has a long history of "Courtesy demands reciprocity". The culture of gift-giving has been long rooted in the nation's blood. Even in modern society they follow many old traditions of gift-giving, and sometimes problems cannot be solved without gifts.

Luxuries can be excellent gifts with their character of excellent quality, scarcity, exorbitant price and profound cultural foundation. Especially in business activities, luxury goods make both the gift giver and the receiver feel "to be faced" which means they feel honored. Some companies also send luxury gifts to their employees to reward them for their excellent performance. It is estimated that in China more than half of luxury goods are bought as gifts. (Xiao Lu, 2010)

3.2.2 For personal use

Compared to the first category, the purchase of luxury products for personal uses is much more common in the Chinese consumer lifestyle. In this report I have classified four groups of consumers who have different features. For the wealthy groups, luxury goods are very ordinary because they can easily afford them. They buy the luxury goods mostly because of the superlative quality.

Table 2 The motives of the wealthy for buying luxury goods

motives	percentage
excellent quality	48%
displaying	16%
symbol of status	14%
trend	14%
investment	2%
recommendation	2%
way to experience foreign culture	1%
N/A	3%
Total	100%

Source: HSBC, 2007

Table 2 shows that nearly a half of wealthy people buy luxury goods because of their high quality. Still there is 16% and 14% of the rich population buy luxuries for displaying and symbol of status respectively, and 14% of the consumers are following trends. Only 8% of wealthy consumers buy luxury goods for other reasons including investment, as a result of others' recommendations, or as a way to experience foreign culture.

As for the post 80s generation, the research shows that compared the post 60s and post 70s, they tend to buy luxury goods for "excellent quality" and "self-award", there's no obvious difference in the dimension of "showing wealth" and "over riding others" (Zhang Mengxia, 2009). These are homogenous features of the behavior of consumers below 45 years old.

3.3 Chinese consumers' attitude to Chinese and foreign brands and their preference for luxury products.

3.3.1 Local and international brands

A recent social survey shows that most of the top 50 luxury brands in China are foreign: 68% from Europe, 28% from North America. Chinese local luxury brands are almost absent from the list. The survey also reveals that the Chinese are used to associating luxury goods with Europe. Classical luxury brands with hundreds of years' history and which are rooted in European culture and nobility are the most popular among Chinese consumers (Chinese

news, 2011/05/17).

What is the reason for the relatively lower recognition of Chinese luxury brands? Professor Bruno Godey of the University of Rouen believes that the important reason for China's lack of worldwide recognized luxury brands is that China is associated with an image of industrial production, that is to say, mass production, which is not consistent with the sort of images associated with luxury goods. (Fei Feng, 2011)

China's prime representative of the World Luxury Association Ouyang Kun pointed out that "Made in China" does not match the image and taste of luxury goods. Different from western consumers, Chinese consumers do not recognize and buy local products. In western countries, people like to buy local products rather than foreign ones. They insist that if you do not even believe in your own country's products, how can you trust products from other countries? (Sylvie Laforet , Junsong Chen, 2010). The findings show country of origin does not affect Chinese brand value, and brand familiarity influences Chinese consumers' decisions.

3.3.2 The categories of luxuries that Chinese consumers prefer

It is estimated that in 2008, US\$27 billion were spent on luxury goods in China. Most of them were spent on cosmetics, jewelry, costume, accessories, and watches and so on. (Hu Xiaohong, 2011, Chinese spent 20 billion on luxury goods during the past "Golden Week".)

2009 China luxury goods market by product category (RMB B)

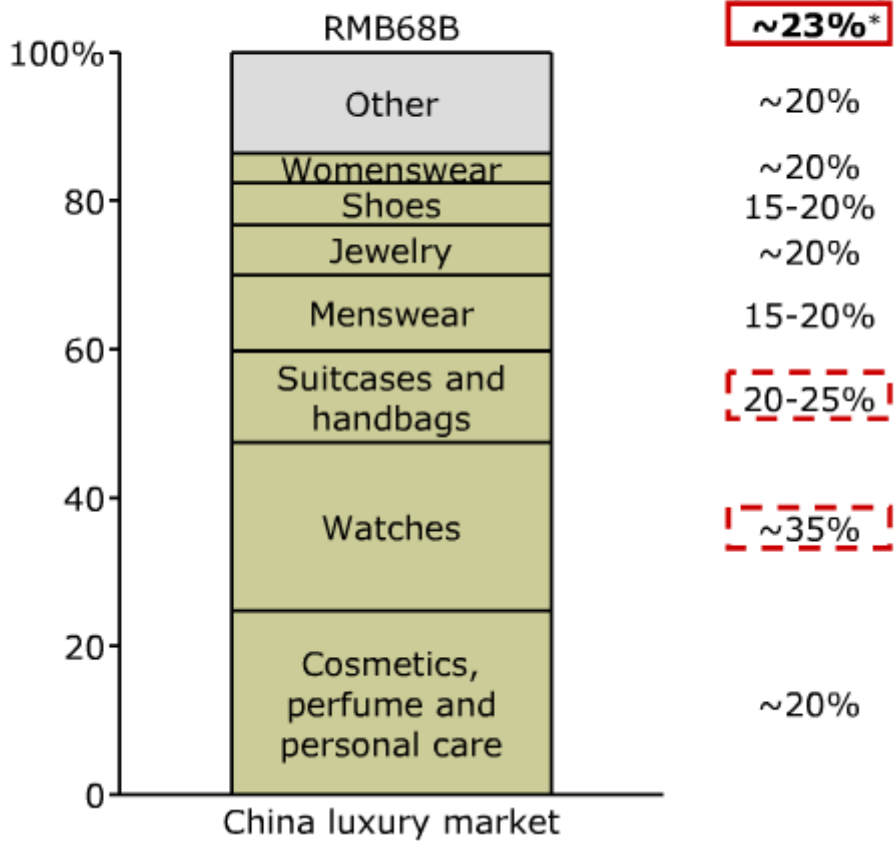
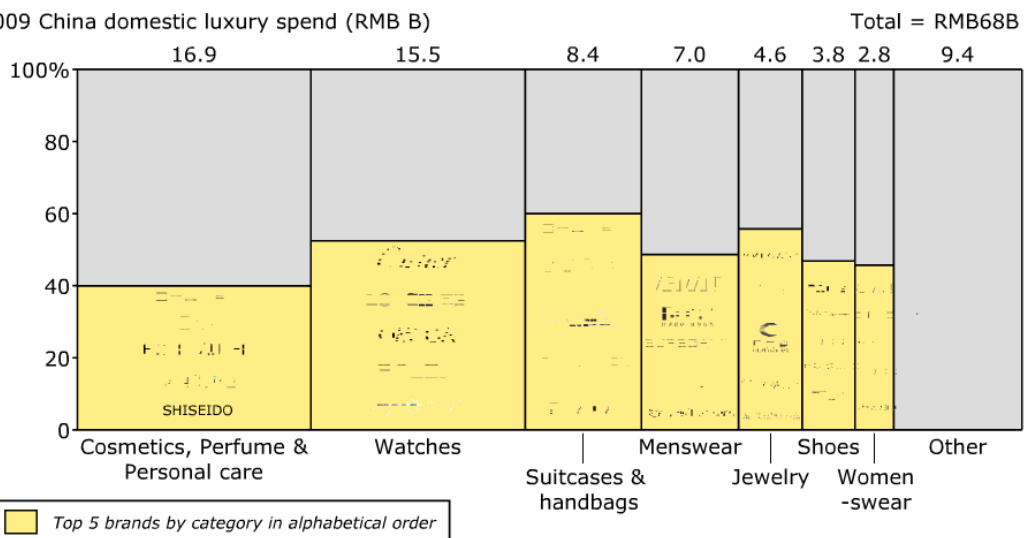


Figure 5. 2009 China luxury goods market by product category.

2009 China domestic luxury spend (RMB B)



Note: Market value is composed of sales at retail value; "Other" category includes tableware/silverware, stationery, sunglasses, accessories and other niche luxury goods items; "Suitcases & handbags" includes smaller items such as wallets; ranking of luxury brands is in alphabetical order; Armani brand includes Giorgio Armani, Emporio Armani and Armani Collezioni

Figure 6. 2009 China domestic luxury spend

Source: Bain & Company Report—China's luxury market: Present and Future

The result of the survey shows the centrality of luxury consumption in China. This means Chinese consumers are already influenced by others' choice of brands. The top 5 brands of different kinds of luxuries occupies about a half of the market share. The most famous luxury brands own the most attentions. LV, Gucci, and Chanel are the luxury goods that most Chinese consumers dreamed of possessing in 2010. Prada in shoes, Giorgio Armani in Women's dress, and Versace in Men's clothes, entered the top 3 in their categories for the first time, becoming the new favorites of the luxury brands.

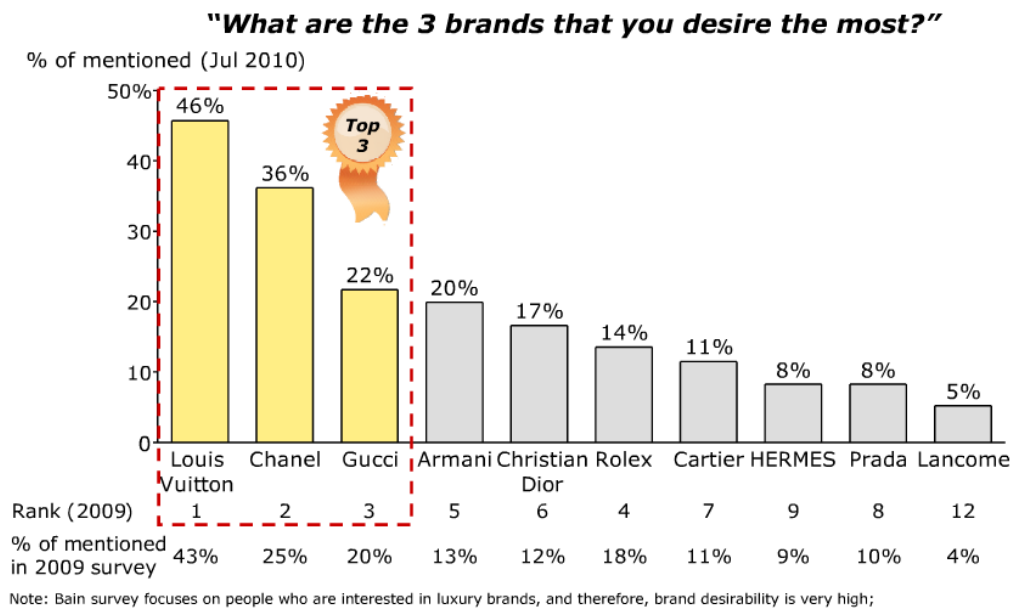


Figure 7. Most popular luxury brands in China.

Source: Bain survey of luxury goods consumers in mainland China 2010(n=1,471).

Euromonitor. Brand Interviews.

In other countries, because most luxury goods consumers are rich people, they buy yachts, helicopters, and top brand cars such as Lamborghini which cost millions of dollars. However, in China some of the luxury consumers cannot afford these kinds of top luxury goods. Therefore clothes, watches, perfumes are more popular in China. They are much cheaper yet can also enhance the status of their owners.

3.4 Intrinsic motivations for buying luxuries.

Most contemporary research into luxury consumption agrees on the well-established concept of conspicuous consumption, which insists that it's in people's nature to consume highly visible goods to show off their wealth and maintain or achieve higher social status.

The so-called Veblen Effect describes the willingness to pay a much higher price for a similar product that the purchaser perceives to be more prestigious (Bagwell and Bernheim, 1996).

Studies show that people buy luxuries for 3 reasons: desire for quality, self-rewarding experience and self-esteem (Yann Truong, RodMcColl, 2011).

As for China, affluent Chinese consumer behavior is influenced by Confucian values: collectiveness and family, respect and superiority, and glory and awareness of shame (Xiao Lu, 2008, p. 6-7).

Collectiveness and family This is a key influence on individual behavior in China and a reason for the success of some ostentatious luxury brands such as Rolex, LV, Armani, and Dior. It is the desirability of belonging that makes affluent Chinese consumers pay more attention to the brands rather than the products themselves.

Respect and superiority Chinese people believe that by wearing luxury brand products, they will receive more attention and respect from others. In this way they fulfill their need of the feeling of superiority.

Glory and awareness of shame China is a "face saving" nation. Wearing or using luxury brands means that an individual is rich and, of course successful. Not only the luxury goods bring glories and respect to the family, but also raise the individual's social status. This kind of pressure often drives people to be vain and even distort their values. Veblen (1899, p. 74) characterizes this behavior as follows: "*... the consumption of these more excellent goods is an evidence of wealth, it becomes honorific; and conversely, the failure to consume in due quantity and quality becomes a mark of inferiority and demerit.*"

4 The Luxury Market in China During The Last 10 Years

The 1970s heralded the start of luxury culture in China, when Pierre Cardin was invited to perform a fashion show in the Imperial Palace in Beijing in 1979. During the 1980s, Montagut, Crocodile, and Playboy entered Chinese market one after another. The Chinese began to know the concept of "brand" and to seek after the brand. While in the western countries, luxury which was once designed for royal families and noble families began to appeal to a larger market. Luxury consumption spread globally.

Until the 1990s, luxury goods had the opportunity to enter the upper class market in China only through the vehicles of five star hotels intended primarily for foreign visitors. The Peninsula Beijing decorated its two-floor basement as galleries for selling luxury goods. Here Ermenegildo Zegna opened the first flagship store of luxury products in China in 1991. LV opened its first franchised store in China here too. Burberry appeared in the Hilton hotel in Shanghai in 1993.

It has been 20 years since the debut of luxury goods in China. In 2002 China became a member of the WTO. From then on Chinese policies regarding imports have become more and more open. As a result, foreign luxury brands appeared like the bamboo shoot after raining. Nowadays luxury goods can be found in many cities besides Beijing and Shanghai. After 2007 the most rapid growth of luxury goods market was not in Beijing or Shanghai, but the second line cities like Chengdu, Dalian, Chongqing, Wuxi, Wenzhou, and so on. It is also estimated that the trend is that more and more shops will be opened in the rising and rich second tier cities in the future. 20 of the 30 stores of Gucci are located in the second or third tier cities in China (China News Weekly, 2009).

4.1 Business model changes:

In the early period of the Chinese luxury market, luxury goods were sold in the senior department stores, and the products were displayed according to their brands at the store, which was the privilege of luxury goods. Yansha Youyi Shopping Center was built in Beijing in 1992; from that time the expensive luxury products began to have their fame among the wealthy people in Beijing. In 1993, the shopping center became a joint venture, which was also the first joint venture retail company in China. The luxury brands' companies or their

agents rented the storefront or the counter at a high price. Japanese company Isetan opened in high key in June 1993 in Shanghai. It introduced luxury cosmetics only, and there Chanel set its first sale point in the Chinese luxury market.

At the beginning of the 21st century, the Chinese luxury market had its real growth. As a result, a new business model appeared and developed rapidly. That was the beginning of the flagship store. Foreign luxury companies opened their flagship stores as outlets at the end point of their product chain. The company headquarters supplied products, designed the storefront, and managed the financial affairs uniformly for every flagship store. Direct regulation of flagship stores is beneficial for the company to build its brand image, as well as cultivate loyal customers. The direct sale is the technique which has been adopted by many brands. LV is the most outstanding example of direct sales. Except for the rental of the store, all of the profit and operation are directly regulated by headquarter. Establishing a regular chain of stores is the trend of the luxury market in China in the future.

Currently the popular business model is the deputy channel. In this model the luxury companies are not face to face with the customers. Instead with the aid of an agency, they push their product to the market. But due to its obvious weakness, this model will be replaced by the regular chain gradually in the future. (Chenyu, 2009.)

4.2 Chinese consumers' changes.

In the 1990s, when luxury goods were first introduced in China, their customers were mostly the rich people who could afford accommodation in five star hotels where the luxury goods were sold. With the spread of the luxury market, more and more brands enter the common department stores where those earning average incomes visit. As the poem says "Where once they visited great homes, now the swallows fly into the common houses."

Thanks to the internet and other mass media, information has spread all over the world. The luxury brands are broadcasted in numerous ways to the audience. As a result, everyone knows them. In addition, these are often advertised by famous people, which can easily strike a responsive chord in the hearts of their target markets. Another reason for their growth is that in the last 10 years Chinese people's income has increased dramatically, so they can afford goods that they could never imagine purchasing before. In 2000, the Chinese GDP per capital was US\$930 (656 Euro), and in 2009 it increased to US\$3500 (2469

Euro) (China yearbook 2010). Chinese consumers' attitude towards consumption has changed a lot too. The concept of over consuming is more accepted by many young people in big cities like Beijing and Shanghai. Not to mention the thirst of young people's dream to be in the first line of the fashion.

5 The Current Luxury Market in China.

I have divided the Chinese luxury market into two parts: foreign luxury brands and Chinese local luxury brands

5.1 The foreign luxury brands' performance in China

According to the survey of Nielson in 2007, LV is one of the most popular luxury brands in the Asia-Pacific area. Another four are Ralph Lauren, Armani, Dior and DKNY. The top 3 popular brands are Chanel (15%), LV (15%), Versace (12%) in mainland China, while in HK, the popularity of LV is as high as 23% (in 2007). We can deduce that luxury goods from France and Italy are most popular in the Chinese luxury market.

Of course there are exceptions: in the area of wristwatches, no country can surpass Switzerland. Watches "Made in Switzerland" are considered as the best all over the world. Scotland produces the best whisky, Germany makes prestigious cars. This is related to the nation's history and culture – it can be called the "Stereotyped image".

Famous brands have different situations in China. Currently LV owns 21 stores, Chanel has 3, the number of Gucci is 17, and 23 stores are owned by Ferragamo. Some brands are not popular in Europe but they have developed fast in China.

Store Count of Selected Luxury Brand by end of August 2010

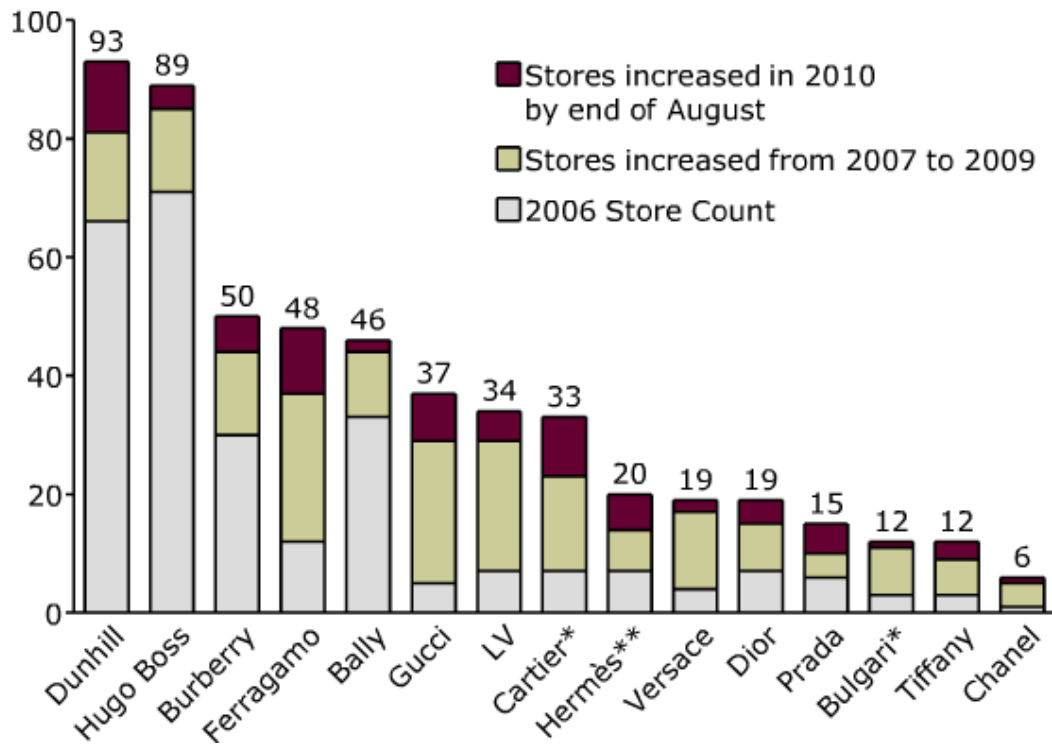


Figure 8 the expansion of luxury brands in China

Source: Analyst reports, Literature search, Brand interviews.

In China, male consumers are the main customers in the luxury market. Compared with other countries, it is rather different. As evidence, take Ermenegido Zegna. Taking into account franchises, it has 52 flagship stores in China.

Table 3. The number of the luxury brands' retail branches in different cities of China.

	Armani	Bulgari	Catier	Chanel	Coach	Dior	Gucci	Hermes	LV	Prada	Tiffany	Zegna
Beijing	6	3	3	2	2	3	4	3	3	3	2	4
Changchun	1		1				1		1			1
Changsha												1
Chengdu	1	1	1		2	1	1		1	1	1	2
Chongqing	1		1									
Dalian	1					1		2	1			2
Fuzhou												
Guangzhou	1	1	1		1	1	1	1	1	1		1
Hangzhou	1		1		1	1	1	2	1			2
Harbin	1		1									
Jinan												1
Kunming	1		1						1			1
Nanjing	1	1			1	1			1			1
Qingdao			1		1		1		1	1		1
Sanya											1	
Shandong											1	
Shanghai	7	1	2	1	4	2	4	1	1	1	3	4
Shenyang	2	1	1		1	2	1		1	1	1	2
Shenzhen	1		1		1		1		1			2
Sichuan												
Suzhou	1							1		1		1
Taiyuan												1
Tianjin	1		1			2	1	1	1		1	2
Wenzhou	1								1			
Wuhan	1											
Xi'an	1				1		1		1	1		2
Xiamen									1			
Zhengzhou												1
Total	31	8	16	3	14	14	17	10	21	9	9	31

Source: Company websites.

From Table 3 we can conclude that Beijing and Shanghai are still the centers of China's luxury markets. But the second and third tier cities should not be neglected.

5.2 The Chinese luxury brands' performance in China.

During the past 10 years of the luxury market in China, more and more Chinese local luxury

brands have come to the market to gain their market shares. However their market shares are much smaller than those of foreign luxury brands. Nevertheless, these Chinese luxury brands have grown very quickly, compared to those foreign or European luxury brands which usually spent more than 100 years to become luxury brands. LV was set up in 1854, Bentley in 1920, Rolex in 1905, Mercedes Benz in 1926, Chanel has over 80 years of history, Estée Lauder was started after the Second World War. Younger brands like CK date back to the middle of last century. Chinese luxury brands only spent 10 to 20 years to grow in the market. The potential of Chinese brands should not be neglected, especially by these foreign luxury companies.

The top 10 Chinese luxury brands are: **1. NE Tiger** Luxury fashion established in 1992. **2. Chow Tai Fook** One of the most famous luxury jewelry brands in China. Founded in 1929 in Canton and then acquired by Hong Kong entrepreneur Mr Chen Yu Tung in 1956. **3. Kweichow Mao Tai** Established in 1999. Maker of China's most famous liquor in China. **4. Omnialuo** Luxury fashion founded in 1998. **5. Erdos Cashmere** Started in 1979. **6. Wuliangye** Founded in 1959. Another top famous liquor maker in China **7. Changyu** Established in 1892. The Company offers 4 categories of products: wine; brandy, healthy liquor, and sparkling wine. **8. Yunnan Pu'er Tea** Established in 1975 and privatized in 2004. In 2005, 500g of 64-year-old Pu'er tea was sold at auction for one million Yuan (1 Euro = 9 Yuan), **9. Dorian Ho** Established in 2004, luxury fashion for after-office hours. **10. Xiangyunsha Silk** silk manufacturer established in 2003.

Generally speaking, Chinese brands have 4 pathways to develop in the local and the international market:

1. Independent creation

NE-Tiger is an example of this type. Others brands such as Lao Fengxiang and Mao Tai are a little different from NE-Tiger because they have a long history and in the hearts of the Chinese people these brands are symbolic of the higher luxury Chinese brands. To some extent, they have the same or even better reputation among Chinese consumers. They stand well for China.

2. Acquisition

The establishment of a brand normally requires a very long time. For Chinese entrepreneurs,

buying an existing brand is a good choice if they cannot build a brand image of their own in a short period of time. For example: the acquisition of Hummer by Tengzhong, Wenzhou private companies' collaboration with Pierre Cardin, and that of Zhejiang entrepreneurs with Dalla Pieta.

3. Acquired by foreign brands

Due to various problems some Chinese brands have developed unsuccessfully. Some are taken over by foreign groups. Chinese luxury costume brand Shanghai Tang was purchased by Richemont. Alcohol brand Wenzun was taken over by LVMH in 2007.

4. Cooperation of Chinese and foreign companies.

With the development of globalization, more and more collaborations are carried out across borders. For example Yang Lan and Celine Dion established the luxury brand of custom-tailor jewellery Lan, and made great effort to set up its flagship store named Lan Fine Jewellery. Chinese brands explore their opportunities by various strategies and methods. After a few years of development, Chinese brands have become more famous both at home and abroad. They are fast-growing and have great potential in the future.

6 Chinese Consumers in the International Market and the Attitude of the Chinese Government

The Blue Book of Commerce issued by the Chinese Academy of Social Sciences in the beginning of 2011 states that until December 2009, the total amount of Chinese luxury goods consumption reached US\$9.4 billion and occupies 27.5% of the global market. Surpassing the USA for the first time and behind only Japan, China has become the second largest consumer of luxury products. Figure 9 illustrates the growth from 2008 to 2009.

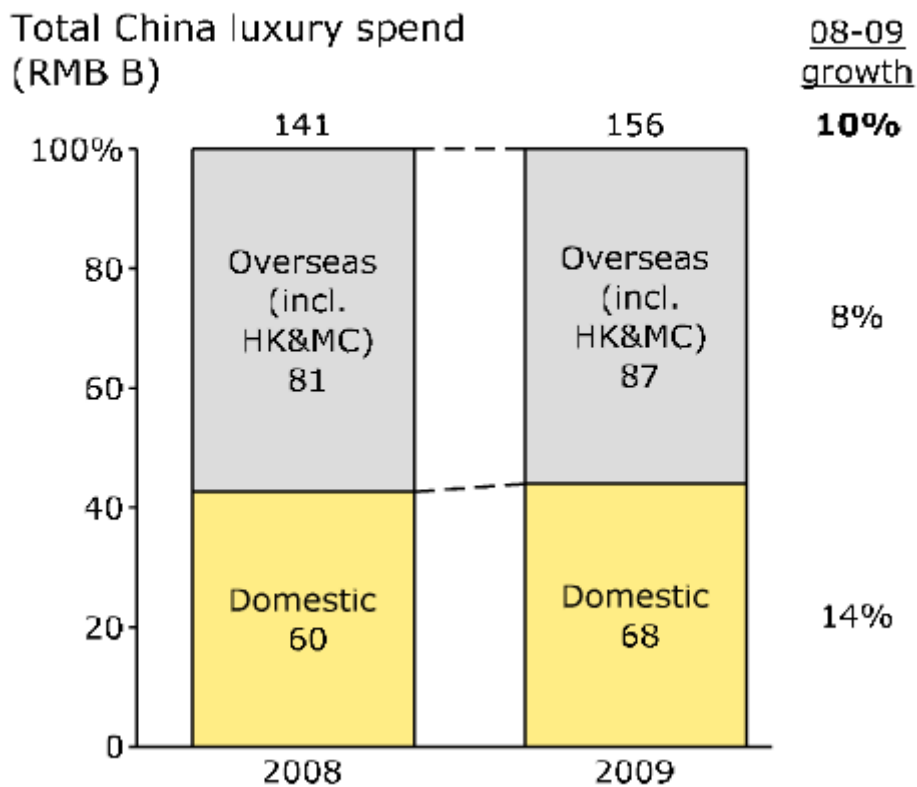


Figure 9: 2008 – 2009 growth of luxury market in China.

Source: Bain survey of luxury goods consumers in mainland China 2010(n=1,471).

Euromonitor. Brand Interviews.

Note: Bain analysis doesn't include the following service: hotel, restaurant alcohol, luxury car, and yacht/private jet.

"What % of luxury purchases (in value) are from overseas vs. in China? And why?"

of responses

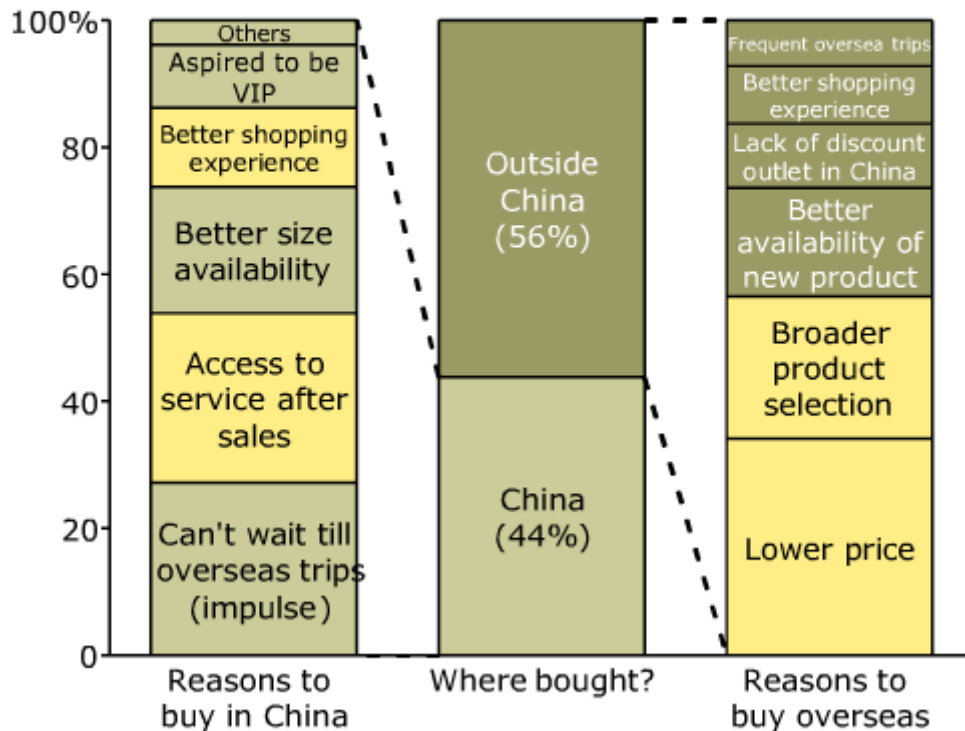


Figure 10 Willingness of buying home or abroad, and the reasons.

Source: Bain survey of luxury goods consumers in mainland China 2010(n=1,471).

Euromonitor. Brand Interviews.

The speed of growth can be considered as startling. In the 2006 IPSOS survey China was just in fourth place in the global luxury market, following Japan, the USA, and Europe. (IPSOS, 2006) Although this survey covered only clothing, the importance of Chinese luxury markets was indisputable. And several institutions, including Goldman Sachs and Bain and Company, have forecasted China will become the leading luxury market in the world. The overseas Chinese consumers also attract much attention from both home and abroad.

6.1 The role of the Chinese consumers in the international luxury market

20 years ago foreign media reported the "spectacular scene of Japanese tourists' purchasing behavior in the international market. Clusters of Japanese tourists with their

cameras flooded into the luxury brand shops. Pointing the products on the shelves they shouted: "We would like to buy the whole of this shelf!" (Wall Street Journal, 1981)

Nowadays the Chinese play the role of the Japanese 20 years ago. Chinese people with different accents are today seen in many famous department stores in the USA during the holidays when there are discount campaigns. In Britain, luxury goods consumption from the Chinese accounts for almost one third of the total, while native British consumers account for only 15%. (Xiao Lu, 2010)

News reports about the "Crazy Purchase" of the Chinese appear everywhere. American media reported Las Vegas stories of Chinese tourists. A visiting group of 800 Chinese travelers came into the Macy's store located in Las Vegas Avenue, poured cash and swiped credit cards extravagantly in the store. They made the assistant so surprised and shocked about the craziness of the Chinese. According to the department manager, during the week of Chinese New Year, Chinese throwing around their money here has reached 4 to 5 thousand US dollars per consumer. (China Daily, 2011)

Reports from ILTM and Hurun declared that the Chinese tourists consumed most in 2010 in the world for the first time. The amount accounts for 17% of the total transnational consumption. The Guardian quoted reports to say that the clothing purchase ability of the Chinese will be 44% globally in 2020. (The Guardian, 2010) Chinese tourists are the biggest group of foreign shoppers in France, buying 650 million euro of duty free items in 2010, a recent survey by Global Refund showed. (Global Refund, 2010)

Citing unidentified sources, a recent article (China Daily, 2011) said China's finance ministry may unveil a revamped tax system before the National Day holiday in October so that Chinese consumers can buy luxury brands such as Christian Dior and Louis Vuitton at home over the Christmas and New Year holidays.

An article in the website of Ministry of Commerce R.P. China says,

"China's high import duties of 50 percent for cosmetics and 30 percent for high-end watches have driven many rich Chinese mainland consumers to shop in Hong Kong, London and Paris, a trend that several Chinese ministries want to change, the 21st Century Business

Herald reported. The bid to keep well-heeled Chinese shoppers at home is in line with Beijing's over-arching plan to boost domestic consumption and cut China's dependence on exports to drive its economy, the world's second largest. With the new taxes, duties on imported cosmetics, milk powder, watches, clothes, suitcases and shoes are expected to be reduced or even scrapped entirely. (Ministry of Commerce R.P. China, 2011)

Recent reports published statistics for the overseas luxury market in the National Day golden week in 2011 (the first week of October). 2.6 billion euro was spent on luxury goods by the Chinese travelers in seven days. The number is equal to the sales of 3 months in the mainland luxury market. Analysis of the World Luxury Association reveals that the consumption desire of the Chinese in other countries is 3 times higher at least than in the mainland. During the seven days, they spend 2,000 to 8,000 euro on average. The luxury goods they buy are mostly clothes, French cosmetics, perfume, and leather products. Chinese tourists have replaced Japanese and European travelers as the main consumers in the international luxury market and have become the largest group of buyers. Take the example of HongKong: during the short 7 days, seven hundred thousand mainland travelers visited HongKong and spent 4.2 billion HongKong dollars (about 0.382 billion euros). Meantime, mainland luxury market was rather bleak. The total amount of luxury goods consumption was merely 17.6% of the HongKong's. Not to mention Shenzhen and Guangzhou, the neighbors of HongKong, only sold out 4% of their HongKong counterparts in terms of the same brands. (Sina, 2011)

6.2 Chinese Government's attitudes to the luxury goods market.

Currently imposed on the luxury goods imported to China's mainland are 3 kinds of taxes: import tariffs from 6.5%-18%, value added tax of 17%, and an excise tax of 30%. In total the tax on luxury goods can exceed 60%.

Recently the problem of "whether the luxury goods tax should be reduced" has been debated in different areas of Chinese society. Among all of the opinions the attitudes of the Ministry of Commerce and the Ministry of Finance are most official and interesting.

Luxury goods makers and government officials from the finance and commerce ministries have held closed-door meetings to discuss China's new tax model, The 21 Century Business Herald reported in June. (Ministry of Commerce R.P. China, 2011) The article of Ministry of

Commerce also cites some results: Owing to hefty import taxes, prices of 20 luxury brands of watches, suitcases, clothes, liquor and consumer electronics in the Chinese mainland are 45 percent higher than those in Hong Kong, 51 percent higher than US prices, and 72 percent higher than French prices, a study by China's commerce ministry showed. (Ministry of Commerce R.P. China, 2011)

The Ministry of Commerce declared publicly that China will further reduce its tax in the future to respond to the popular concern about the "over high tariff problem". It was said that all of the ministries had already reached a consensus about this viewpoint. But a few days later, Ministry of Finance issued an article in its official website to contradict the news of Ministry of Commerce. This article named "Luxury tariffs should not be abolished or reduced" cited the viewpoint from Liu Shangxi, who is the vice chief of the institute belonging to the Ministry of Finance, that taxes on luxury goods benefit social justice because they affect the rich. So, keeping a high rate of tax on luxury goods is the choice approved by the population. The tariff should even be set higher. (Ministry of Commerce R.P. China, 2011)

This article also pointed out that the tax is not the root cause of buying luxury goods in overseas market. Some travelers buy luxury products abroad because of the more reliable quality and the idea of showing off their wealth.

This battle between the two ministries lasted for months. For now, there is still no exact consensus about this topic. When asked questions about luxury goods taxes, the spokesman of the Minister of Commerce Shen Danyang said this problem is not completely the responsibility of the Minister of Commerce. The Customs Tariff Commission of the State Council is in charge of the customs duty rate. He suggested the journalist consult the Commission's office. Rumors suggested that the formal documents relating to luxury goods taxes would come out before October 2011, but as yet nothing has been published.

On the one hand, the leakage of consumption to foreign countries should be controlled to stimulate domestic demand. On the other hand, the effects from the loss of tax income should also to be taken into account. This paradox might be the reason why the two ministries had a dispute about this problem.

There are also some rational voices from the government and academics. Some experts pointed out that the adjustment of the luxury goods tariff is not crucial at this moment. What is most important is to classify the luxury goods that are eligible for tariffs.

How to deal with this difficult problem? Vice chief of the Financial Science Analysis Institute within the Ministry of Finance Liu Shangxi believes that first the scope of luxury goods should be classified. Products that previously were considered as luxury goods might no longer belong to this category. So the explicit list of luxury goods should be replaced. On the basis of the list taxes are imposed separately. (Huang Jinghua, 2011). He insisted that the tax of "real luxury goods" could not be reduced. For these luxury goods which closely relate to daily life, the rate of the excise tax and import tariff might be reduced. Meanwhile, it is impossible to lower the rate of value added tax. Some experts state that luxury goods can be classified according to 3 categories. The first category is the supreme level, including private planes, yachts, luxury cars, which is the A series. The second category is the middle level, including watches of famous brands, jewellery, which is the B series. The third category is the basic level, which refers to clothing, bags, cosmetics, perfumes. They are classified as the series C. (Ministry of Finance, P.R. China, 2011)

7 The outlook for the Chinese luxury market

7.1 Future growth prospects for the Chinese luxury market

Reports from Bain & Company state that in 2009, the Chinese luxury market increased by almost 12%, reaching \$9.6 billion us dollar (6.97 billion euro), and equivalent to 27.5% of the global luxury market. It is estimated that in the next 5 years Chinese luxury market will increase to \$14.6 billion us dollar (10.6 billion euro) and be the world leader. (Bain & Company, 2009)

Boston Consulting Group has an even more optimistic estimation. It estimates the total consumption of the Chinese market will be up to 248 billion Yuan (28 billion euro) in 2007 in "The Second Top Brands Summit Forum" in Shanghai, March 27th. (Sina, 2007).

The fast growing Chinese economy has attracted plenty of investors during recent years, including the luxury brands. Louis Vuitton, for example, has increased by 15% every year since 2001 (Xiao Lu, 2010). Goldman Sachs estimates that China will be the largest luxury consumption country in the world and the share of Chinese market in the global market will be around 30% in 5 to 7 years. The amount of luxury consumption will reach \$32.8 billion us dollar (23.8 billion euro). (Sina, 2011)

Although these reports differ in the exact numbers, they all believe that the Chinese market will be second to none in a few years. This view is also accepted by investors, luxury companies and consumers. President of Louis Vuitton China Christopher Zanardi-Landi has much confidence in Chinese market. He predicts the sales of Louis Vuitton will increase significantly in the future. (Tai Siliang, Li Wei, 2010).

The increasing purchasing power and improvement of technology attract more and more investors to China. China has the potential to be the center of both luxury manufacture and its market.

7.2 Future prospects for foreign luxury brands in China

With the ever increasing purchasing power of the Chinese consume power, luxury brands continue to flood into the Chinese market.

Mindful of the demand of Chinese consumers, many famous European and America clothing companies are scrambling to open branches in China. For example, British brand Vivienne Westwood planned to open 20 branches in China in 2010; Burberry also decided to increase its current 44 stores to 110 stores by the end of 2012. Famous American leather brand Coach has plans to open another 20 shops in China. And Italian company Ferragamo plans to launch 20 branches in the near future. Other information suggests that Gucci has intentions to enter the Shanghai market, and Dior held its fashion show there in May, 2010. (Xiao Lu, 2010).

These brands not only aim for the big cities like Beijing and Shanghai, but are also accelerating their efforts to expand into the second and third tier cities. In 2010, Cartier recognized Zhengzhou as one of the important cities in its touring map. Because of the bumper profit in the Chinese market, these luxury brands strengthen their business here, spreading their net to more inland cities. Taking the example of LV again, the average growth rate per year of its sales has been never below 50% since it entered the Chinese market 16 years ago. China is LV's third largest national subsidiary in the world. There were 26 stores in China in 2008, spread in 12 cities. (Li Yang, 2011)

Huatai Lianhe Security (2010) reveals that the markets of the third and fourth tier cities are just like the second tier cities 5 years ago. Demand is growing dramatically whilst the supply is relatively static in terms of both commercial real estate and other areas.

Since 2007 the third tier cities have already replace the first and second tier cities to become the most fast-growing area in the retail market. According to Huatai Lianhe Security (2010), the total capacity above market the ceiling could be 400 billion Yuan (about 45 billion euro). In third and fourth tier cities, the businesses are mainly street vendors, where fine suppliers are lacking. They are nearly the virgin land of the luxury market. It is estimated that 65% of Chinese consumers' purchasing power is contained there (Huatai Lianhe Security, 2010). Due to the importance as well as the huge potential of the third and fourth tier cities, many luxury brands aim to explore this virgin land of the luxury market. Rich cities like Wenzhou are the most considered location by international luxury companies. Not belonging to the first and second tier cities, Wenzhou has a large number of millionaires (Hurun Corp, 2010). The density of the rich might be higher than most of cities in China,

because Wenzhou is the capital of Chinese private enterprises. Investors believe that the expansion in Wenzhou will be very successful.

7.3 Future prospects for the Chinese e-commerce luxury market

The largest website retailer of famous brand products www.vipshopping.com claimed that they would introduce luxury brands in 2011 at the moment that they accepted capital from Sequoia Capital and DCM of US\$20million (14.528 billion euro) in early November 2010 (Qiu Jing, 2011). Previously, its Japanese counterparts Glamour-Sales entered the Chinese market in high key. Additionally, Forzieri.com and other overseas online stores aim to explore the Chinese market and share a part of the profitable Chinese luxury market.

With the high demand of Chinese consumers, especially demands from the middle income consumers, we believe that the Chinese e-commerce market of luxury products will have a bright future. Also with the huge gap between the prices of local and overseas market, for many the Chinese online luxury market seems to be alluring. In fact it is a huge cake that every e-commerce companies wants a part of.

The customers of the luxury goods online stores are mainly the consumers who have a well-paying job. Compared to the wealthy, they pay more attention to the price-quality ratio. Their consuming behavior can be described as follows: no seeking after the new arrivals of the season; buying mostly the primary level luxury goods (e.g. perfume and handbags are more preferred than watch and jewellery).

Meantime, online shopping has developed from smaller expenditures to larger purchases. This builds a good base for the luxury online sales. Currently, most of online luxury consumption is delegations to buy abroad by buyers. Taking the example of LV again, if you input "LV certified purchasing agents" in the searching area of Taobao.com, the largest online shopping store in China, links to nearly 500 shops will appear. Most of them buy luxury products from Hong Kong, France, and Britain.

Following the trend many luxury brands also opened their online flagship shop in recent times. For example Giorgio Armani set up its official online shopping website www.emporioarmani.cn in November 28, 2010.

Compared with the entity stores, official shopping websites and the outlets, online discount shops have obvious advantages in terms of penetration to consumers as well as personal guides to consumers. It is believed that this business model will be the mainstream in the coming years in China. (Qiu Jing, 2011)

Great prospects notwithstanding, still the discount online luxury shops face a lot of challenges. Mass awareness of luxury goods is the solid basis of the luxury market. Consumers' concern about the price-quality ratio is the key point regarding the development of the luxury market. Online markets are full of high quality counterfeited luxury products and copycat products, which is the chief obstacle facing the online discount shops as they try to improve their market position. The primary task of these online luxury shops is building the trust of the customers in them. Other problems such as the time interval from ordering to receiving, the defects of online purchases, as well as logistics will test the online discount shop too. Sometimes these supporting services can be the critical factor that decides the success of an e-commerce company.

With the growth of the online discount shops numbers, fierce competition cannot be avoided. It is important for the online shops to differentiate from each other, rather than fall victim to homogeneous competition. The online luxury market can be also the niche market, if these websites innovate in market location, product source choice, purchase methods, and individualized service, in order to forge their own identities. Now the online discounted luxury market is still in its infancy, consumers will enjoy a long observation period of its progress to maturity. This period is also the critical time for websites to guide their consumers' behaviors and nurture their loyal customers.

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