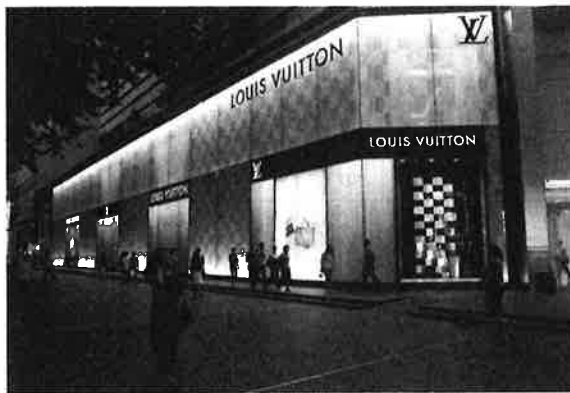


## LVMH in China: Cracks Its Empire of Desire?

**IN JULY 2012**, Louis Vuitton, the flagship brand of France's Moët Hennessy Louis Vuitton S.A., better known as LVMH, opened its 16th global Maison at Shanghai's Plaza 66, a huge luxury mall. The Shanghai Maison would house the entire range of Louis Vuitton collections and multiple contemporary artworks created by Chinese and international artists. The grand opening of the Shanghai Maison also coincided with the 20th anniversary of the brand's presence in China; Louis Vuitton opened its first store in the country in 1992, in Beijing's Peninsula Hotel. Indeed, sales in Asia (excluding Japan) accounted for one-third of total revenue by the end of the first quarter of 2015, making Asia LVMH's largest region in terms of revenues (see Exhibit MC24.1).<sup>1</sup> When focusing on countries rather than regions, China is already the world's biggest luxury market (Exhibit MC24.2), having achieved an average annual growth rate of close to 20 percent from 2007 to 2014.

Louis Vuitton loves China; the Chinese love Louis Vuitton too, perhaps even more. In a recent Chinese luxury consumer survey published by the Hurun Research Institute, Louis Vuitton topped the list as the number one and number two preferred luxury brand by Chinese men and women, respectively. Although the brand's heritage and craftsmanship are attractive features to Chinese consumers, they are not solely responsible for opening the wallets of affluent Chinese. Louis Vuitton's steep prices and glamour bestow prestige exclusively on its customers, and this is what Chinese luxury customers value the most—to be recognized as wealthy elites with high social status. To stay apart (or atop) of the crowd is what Chinese customers crave in a densely populated and, technically speaking, an egalitarian and communist society (although much of China's economy is run by capitalist enterprises, some of the biggest are still state-owned). LVMH's image reinforcement is so powerful that even China's middle class aspires to become a Louis Vuitton owner. On average, Chinese Louis



LVMH's Maison in Shanghai, China  
© AP Photo/Zhang Haiyan

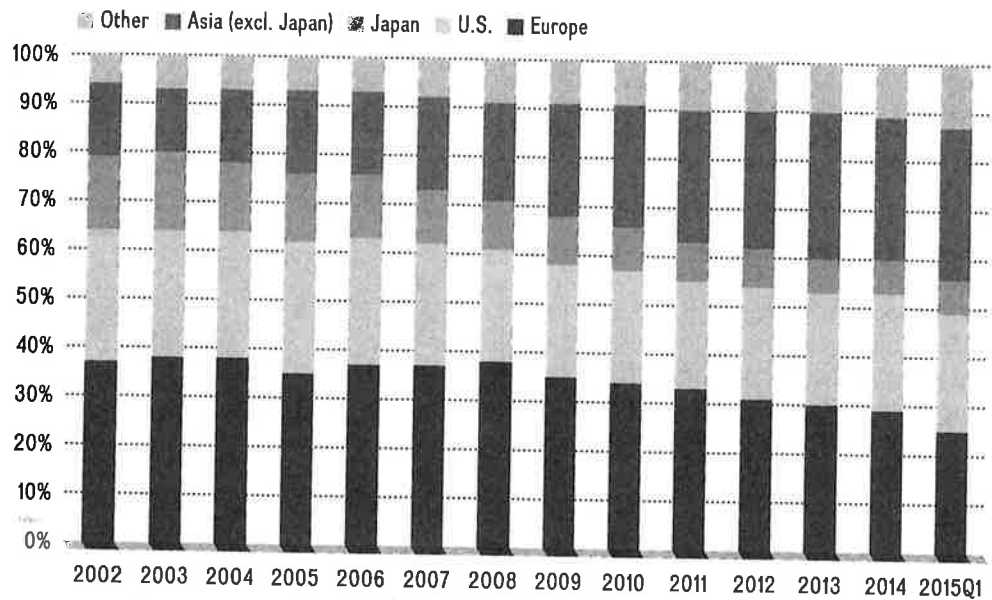
Vuitton customers are younger than their Western counterparts. Moreover, they spend a significantly higher amount of their disposable income to own LVMH luxury status symbols.

With an eager consumer base and the lack of local competitors, there is probably no better tailwind an international brand could hope for in China: after years of heavy marketing to raise consumer brand recognition, everything Louis Vuitton offers sells well; all stores opened in China are profitable.

LVMH has managed its growth well. Since its formation in 1987, LVMH has become the world's largest luxury conglomerate, owning more than 60 brands and 3,200 stores worldwide.<sup>2</sup> It has a remarkable track record in Asia: 85 percent of Japanese women own a Louis Vuitton product. With an early entry into China, LVMH was also able to take advantage of the country's rise to become the largest luxury market

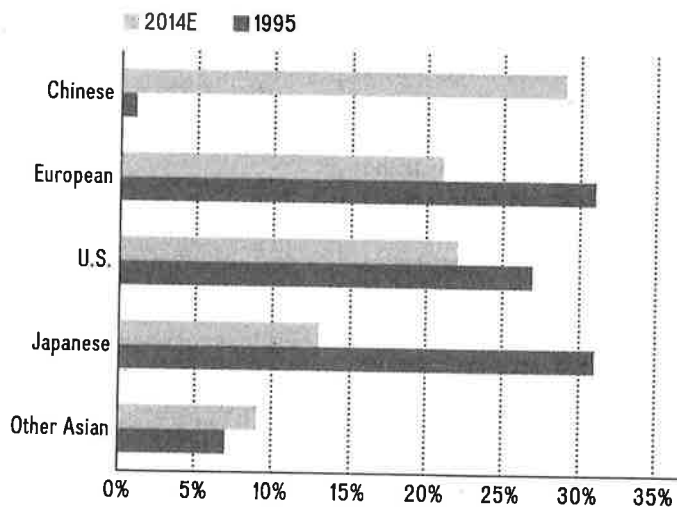
Frank T. Rothaermel prepared this MiniCase from public sources. He gratefully acknowledges the contribution of Ling Yang on an earlier version and Srikanth Prabhu for research assistance. This MiniCase is developed for the purpose of class discussion. It is not intended to be used for any kind of endorsement, source of data, or depiction of efficient or inefficient management. All opinions expressed, all errors and omissions are entirely the author's. Revised and updated: July 29, 2015. © Frank T. Rothaermel.

EXHIBIT MC24.1 / LVMH's Sales by Geographic Region (2002-Q1, 2015)



Source: Depiction of data from LVMH Annual Reports, 2002-Q1, 2015.

EXHIBIT MC24.2 / Luxury Market by Consumer Nationality



Source: Depiction of data from "The rise of the borderless consumer: Luxury goods worldwide market study," Bain & Co., Fall-Winter 2014.

worldwide. Not only did it capture the luxury lovers in Beijing, Shanghai and the like, LVMH also opened stores in second-tier provincial capitals and wealthier third-tier cities in the west of China, where speedier

growth is expected in the coming years. LVMH has 50 stores in China.

After nearly a decade of successful expansion, LVMH recently turned more cautious. LVMH's

concern in China is to “avoid becoming too commonplace.”<sup>3</sup> Although the new rich in second- and third-tier cities are still craving luxury goods, signs indicate consumers in Beijing and Shanghai are maturing. The more sophisticated consumers now embrace uniqueness and understatement in luxury items; they have become well-traveled global consumers and are shying away from “logo-heavy” mega-brands, such as LVMH handbags. LVMH’s reputation is in large part built on the exclusivity and prestige it conveys, but it now faces the threat of brand overexposure.

To respond to changes in consumer taste, LVMH stopped opening stores in China and launched the Shanghai Maison with invitation-only floors. It also offers custom made-to-order bags using exotic skins to project exclusivity for top-end customers. It began to focus on leather products with high value added rather than entry-level canvas logo style. In addition, it has promoted a set of “logo-free” handbags targeted exclusively at high-end Chinese customers.

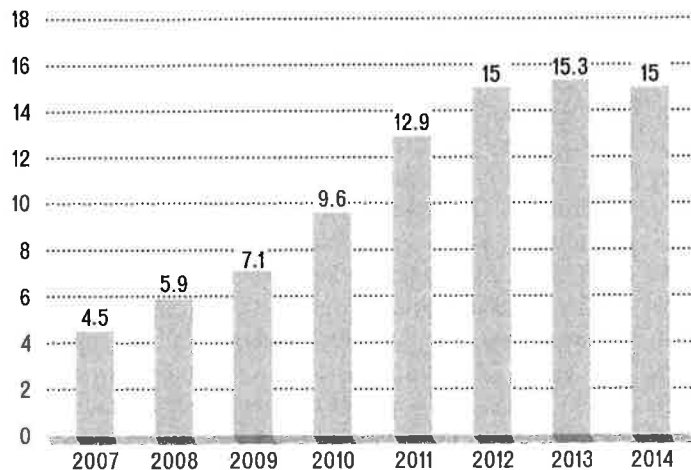
But LVMH’s decision to limit store growth may have another reason: Many Chinese have chosen to buy abroad. The main reasons Chinese consumers cite for shopping overseas, in addition to better selection and greater “show-off” value, are lower prices due to China’s high luxury taxes and the weak euro. Taken together, this makes LVMH products in China twice as expensive as they are in Europe. It is quite common to find busloads of Chinese tourists queuing to purchase merchandise outside Louis Vuitton’s boutique on Avenue des Champs-Élysées in Paris. Although it has created growth stimulus for LVMH Europe, it also poses significant challenges, such as managing inventory and providing adequate services. Before the holiday season, for example, Louis Vuitton had to put in drastic measures to slow sales. In its flagship Paris stores, LVMH limited the total number of leather products available for purchase for each customer and reduced store hours. In addition, Louis Vuitton’s European stores have hired Mandarin-speaking staff trained to better meet Chinese needs and better handle the spikes of tour-bus traffic. Meanwhile, LVMH aims to strengthen its relationship with Chinese customers at home by providing premium services and enhancing their shopping experience. As long as the price difference exists, however, stores abroad will continue to be Chinese customers’ preferred shopping destination. Despite all of LVMH’s efforts to channel Chinese demand toward domestic outlets, demand at LVMH stores in France and other EU countries

has increased significantly as the euro has fallen by 30 percent in five years.

Like all other luxury brands, LVMH has to constantly fight against counterfeiting of its products, especially the Louis Vuitton brand. China’s dominance in manufacturing and its lack of intellectual property law enforcement have made the country home to more than 80 percent of the estimated \$300 billion counterfeit industry. To keep some control over its intellectual property, LVMH manufactures its leather goods in company-owned factories in France, Switzerland, Germany, Italy, Spain, and the United States. Since the early 2000s, LVMH’s Chinese anti-counterfeiting team, together with its global specialists and investigators, has raised public awareness of the illegitimacy of the counterfeits and stemmed the flow of the counterfeits from China to the developed world. It also brought legal actions against pirates who made fake goods and landlords who provided premises to the pirates. LVMH has achieved much success in China, including winning several recent cases in Chinese courts. But as long as the popularity of its Louis Vuitton handbags lasts, the anti-counterfeiting battle goes on, further contributing to a potential loss of exclusivity.

The road ahead in China, however, is becoming more challenging for LVMH. Chinese President Xi Jinping’s campaign against corruption has drastically reduced the demand for luxury items that were purchased as “gifts” to curry favor with government officials. In addition, wealthy Chinese have become more cautious in flashing their wealth through conspicuous consumption (spending of money on luxury goods to publicly display wealth and status), given a recent public backlash against wealthy individuals and high-profile trials for corruption. As a consequence, LVMH’s sales in China have plateaued over the last three years (Exhibit MC24.3). In addition, the Chinese economy is beginning to slow, and sustaining double-digit growth rates in the future seems unlikely. Volatile stock market swings have also rattled the confidence of Chinese consumers, with the Shanghai composite index losing more than 25 percent of its value during the summer of 2015, despite heavy government intervention to stem the sell-off. Yet, despite the stagnant demand from China, LVMH reported an attractive 16 percent yearly growth in 2015. On the downside, this result was mainly due to the weak euro, and LVMH’s net growth was a mere 3 percent after stripping out currency effects.

EXHIBIT MC24.3 / Luxury Market in China, 2007–2014E\*  
(euro's billions)



\*E indicates an estimation.

Source: Depiction of data from Bain & Company.

### DISCUSSION QUESTIONS

1. Why has LVMH been so successful in China? With the Chinese economic slowdown, do you think there are risks to LVMH growing aggressively in China? What do you think should be its strategy in China going forward?
2. Which strategic initiatives does LVMH pursue to strengthen its position in China? In particular, how does LVMH encourage Chinese customers to purchase LVMH products in China rather than abroad? Do you think these strategic initiatives will be successful? Why or why not? What other ideas do you think LVMH should pursue to encourage Chinese customers to purchase LVMH products in China?
3. Louis Vuitton is LVMH's flagship brand. Much of Louis Vuitton's appeal is that it bestows exclusivity on its owners. In the last few years, however, the Louis Vuitton logo has been applied widely with handbags and accessories proliferating at an unprecedented speed. In addition, counterfeiting further leads to a proliferation of the "Louis Vuitton brand." One analyst concluded that LVMH is "way overexposed in China, with too many stores and too much in fixed costs."<sup>4</sup> Is LVMH changing its strategic position of Louis Vuitton from a focused differentiator to a broad differentiator? Is

the brand losing its appeal? Does Louis Vuitton risk being "stuck in the middle"? Why or why not?

4. Given the backlash in China against corruption and conspicuous consumption, what recommendations would you give LVMH?
5. LVMH is a diversified conglomerate owning a number of luxury brands including Louis Vuitton (fashion and leather goods), Bulgari and Tag Heuer (watches and jewelry), Moët et Chandon and Dom Pérignon (wines and spirits), and Dior (fashion, perfumes, and cosmetics). Identify core competencies, economies of scale, and economies of scope that would allow LVMH to create value as a diversified conglomerate ("diversification premium"). What factors could lead LVMH to destroy value as a diversified conglomerate ("diversification premium")? Explain.

### Endnotes

- <sup>1</sup> Excluding Japan; LVMH does not break down sales for China.
- <sup>2</sup> LVMH's famous brands include: Louis Vuitton (fashion and leather goods), Bulgari and Tag Heuer (watches and jewelry), Moët et Chandon and Dom Pérignon (wines and spirits), and Dior (fashion, perfumes, and cosmetics).
- <sup>3</sup> "Louis Vuitton slows expansion to protect image," *The Globe and Mail*, January 31, 2013.
- <sup>4</sup> "Weak euro masks lingering woes at LVMH, Kering," *The Wall Street Journal*, July 27, 2015.

Sources: This MiniCase is based on: LVMH's annual reports, 2002–Q1, 2015; "Weak euro masks lingering woes at LVMH, Kering," *The Wall Street Journal*, July 27, 2015; "China stocks tumble as investors doubt Beijing's help," *The Wall Street Journal*, July 15, 2015; "LVMH Moët Hennessy Louis Vuitton quarterly sales rise 5.2%," *The Wall Street Journal*, October 14, 2014; "Louis Vuitton slows expansion to protect image," *The Globe and Mail*, January 31, 2013; "Has luxury peaked in mainland China," *South China Morning Post*, May 22, 2013; "LVMH rushes to keep up with China's changing tastes," *Jing Daily*, May 27, 2013; "For luxury brands targeting China, expansion to lower-tier cities beckons," *Jing Daily*, June 5, 2013; "Luxury goods in China: Beyond bling," *The Economist*, June 8, 2013; "Wealthy Chinese love French luxury goods," *South China Morning Post*, June 21, 2013; "LVMH: the empire of desire," *The Economist*, June 2, 2012; "Event watch: Louis Vuitton Shanghai Maison grand opening," *Jing Daily*, July 10, 2012; "LVMH faces dilemma of success," *Financial Times*, October 19, 2012; "Luxury without borders: China's new class of shoppers take on the world," McKinsey & Co., December 2012; "Made in China on the sly," *The New York Times*, November 23, 2007; and "Louis Vuitton's Steven Lie: Protecting IP in China," *Asiatrav*, October 2005.