By Ben Simpfendorfer & Ivy Ji

Hong Kong as China's shop window

The world's biggest foreign brands are now well established in Hong Kong, as they not only seek to sell product, but also build profile among the 41 million Chinese nationals visiting each year. More recently, smaller foreign brands have also arrived, resulting in intensifying competition. Indeed, we have counted over 370 foreign brands with at least one store in the city's main malls. The changes are forcing some companies to rethink their strategy.

Chinese shoppers are popularly viewed as owning multiple Louis Vuitton bags or Rolex watches, but many are also increasingly buying lesser known premium brands as they look to distinguish themselves from friends and colleagues. That's good news for the world's smaller brands—such as Guy Laroche, Testantin, or Haglofs—who might have until recently struggled to gain a foothold in China's vast markets.

Part of the problem for smaller premium brands is developing brand recognition in such a large and fragmented market, as only the largest brand owners have the financial strength to open stores in multiple cities. Fortunately, Hong Kong offers a shortcut.

Hong Kong receives some 41 million Chinese tourists annually, each spending an average US$1,100. Many of these tourists are from neighbouring Shenzhen and other southern Chinese cities. But nearly 60 percent originate from cities across China, and all have enough disposable income to make a short visit to Hong Kong affordable, and all are likely to make at least one visit (and usually more) to a shopping mall.

That makes Hong Kong a shop window for brand owners wanting to introduce their products to mainland shoppers: those who buy in Hong Kong will return to cities across China and display their new brands to friends and colleagues and so spread the word.

The result is evident in the sheer concentration of brands in Hong Kong's shopping malls. We recently collected data on 38 malls and counted over 370 Western brands with at least a single outlet (and that's before

Figure 1: Foreign brands in Hong Kong's malls

Out of

372

Western brands in Hong Kong's malls

248

have at least one store in a first-tier mall

177

have stores in both first-tier and mass-market malls

126

only have stores in mass-market malls

counting the equally popular Japanese and other Asian brands). Not surprisingly, tying to catch the attention of shoppers is an increasingly tough challenge for brand owners.

The result is that foreign brands are adopting a mixture of commercial strategies in Hong Kong. Take Canali, an Italian clothing brand. The company recently opened a store below our office in Central's Pedder Street where it is passed daily by hundreds of mainland tourists. It's also Canali's only store in Hong Kong, unsurprising given the rental costs the brand must be paying for such a prime location.

Yet they are not alone in adopting such a high-profile strategy: there are some 69 Western brands in Hong Kong with just a single store in one of the city's first-tier shopping malls, specifically IFC, Landmark, and Pacific Place on Hong Kong Island or Elements in Tsim Sha Tsui. For these brands, the marketing opportunity clearly outweighs the commercial challenges of dealing with high rents and volatile sales.

The majority of Western brands, however, have opted for a mixed strategy, locating a few stalls in first-tier locations and others in the mass-market malls. Take the example of Kate Spade, an American lifestyle brand, with three stores in first tier malls and another three stores in mass market malls. It's a sound commercial strategy that builds profile, but also protects the brand from the high-rents of the first-tier malls.

Most striking though is the spread of foreign brands into secondary mass-market malls. These malls have typically catered to Hong Kong's working population and are often deep in the heart of Hong Kong's New Territories. Consider the example of Alfred Dunhill, a British clothing brand, with four stores in first-tier malls, as well as three in the secondary mass-market, such as Shatin's New Town Plaza.

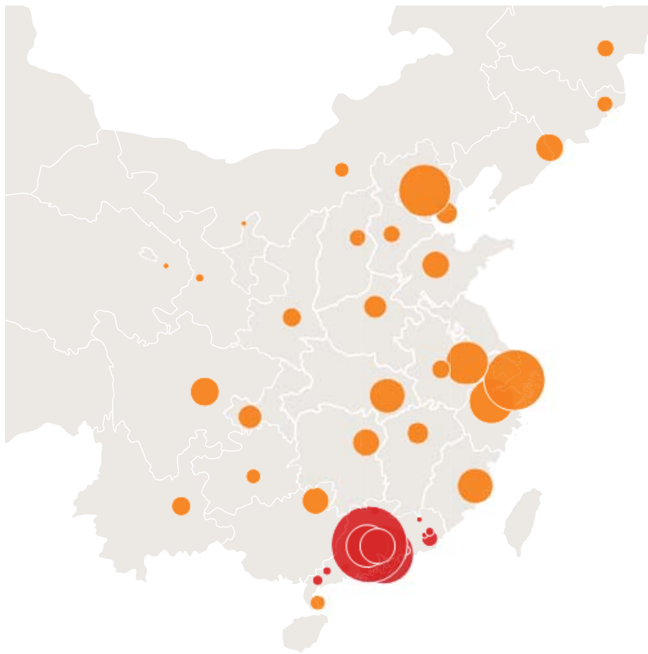
The growing popularity of such malls is partly explained by the fact that Hong Kong is also a shopping mall for neighbouring Chinese cities. Indeed, we recently spent the afternoon surveying retail staff working in New Town Plaza's outlets to understand where their customers were from. Most staff replied, 'Shenzhen', a neighbouring mainland city with a population of eight million people and just 30 minutes away by train.

The maturing of Hong Kong's role as a shop window is not surprisingly forcing foreign brands to ask serious questions about their commercial strategy. Are we in Hong Kong simply to build our profile among Chinese shoppers? Can stores in the mass-market malls offer a better mix of profile and profit growth? Are we targeting all 41 million Chinese visitors or just those on shopping trips from Shenzhen?

Figure 2: Chinese tourist arrivals to Hong Kong by region

The below map indicates the relative share of arrivals by province (orange circles) and by city with respect to southern Guangdong province (red circles), which accounts for 40% of arrivals. Beijing and Shanghai account for a large share. Yet, arrivals from major cities in Guangdong, such as Guangzhou, Shenzhen, and Dongguan account for as many arrivals as entire provinces in the rest of country. Indeed, there are more visitors from the southern city of Jiangmen than from the more northern Shandong province.

Circles relative number of arrivals



Source: HK Tourism Board & SRA

Hong Kong's experience also illustrates the growing opportunities and challenges of selling direct into China. There is clearly an appetite for smaller or lesser known brands. But competition is also intensifying and it's increasingly tough trying to build profile among consumers spoilt for choice, especially since an explosion of e-commerce and digital media means physical stores are not their only option. ■

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