# The chic and the cheerless

## Below a shiny crust of top companies, business in France is in a sorry state

THE number of millionaires in South Korea, India, Russia and South Africa is rising at 15-21% a year. According to calculations by Merrill Lynch, an investment bank, the Asia Pacific area already has 2.4m millionaires, compared with 2.8m in Europe and 2.9m in America. Soon China will be producing its own contingent, in addition to those in Hong Kong. That is of considerable interest to France. Consultants at McKinsey calculate that with the number of super-rich worldwide growing by 8% a year, annual sales of French luxury goods could double to €42 billion over the next ten years.

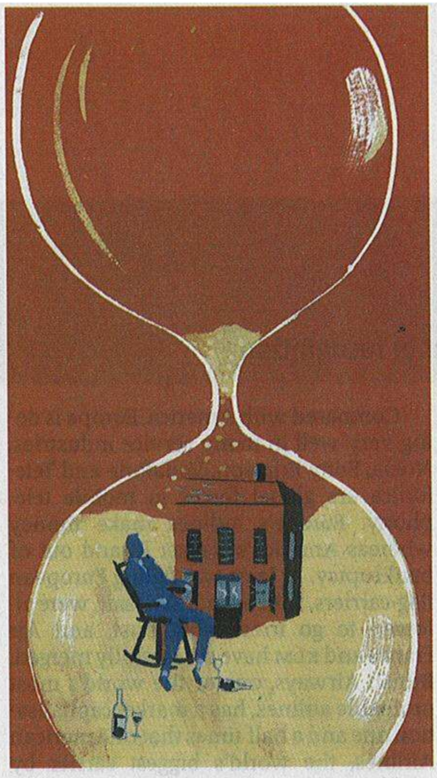
France dominates the world market for luxury goods, with a share of 36%. Wherever the rich or super-rich pop up, they seem to want French luxury brands such as Cartier, Chanel, Hermès, Hennessy, Louis Vuitton and Moët et Chandon. Most other countries can only envy that glittering range. America has got Tiffany and not much else; Switzerland has Rolex and other expensive watches; Germany has Porsche. Only Italy offers much competition, with labels such as Armani, Bulgari, Gucci and Prada. But France's dominance goes far beyond perfumes, champagne and crystal chandeliers; just think of Dassault Falcon private jets, Catana yachts and the deluxe hotels of the Côte d'Azur. France has a leading contender in every segment of the luxury market.

Now, however, the prestigious French labels face new competition. Except for Longchamp, a fancy leather-goods company that started in 1948 and took off in the 1980s, most of France's luxury firms have been around for a long time. Still, they are doing well in new markets. Louis Vuitton, for instance, which is famous for its monogrammed luggage, has opened a dozen shops in ten Chinese cities since 1992.

In recent years, though, Italy has sprouted new luxury-goods firms to challenge France, such as Tod's and Dolce & Gabbana. In the category of affordable luxury, newcomers such as Paul Smith, a British menswear company, and Hugo Boss in Germany have come to the fore. Hugo Boss claims that one suit in six in the €700 range has its name sewn into the jacket. It has widened its product range and is particularly strong in the male-perfume business. It does not trade on being "made in Germany", whereas for luxury goods from France their Frenchness is part of the essence of the brand.

### Trumped by foreigners

In some sectors France has lost ground. Its luxury-shoe sector is declining, not because of the cheap Asian footwear that is wiping out many European mass-market producers but because of a loss of design flair. And even French winemakers can no longer take their pre-eminence for granted. In a recent blind tasting by famous wine experts from America, Britain and France Californian wines did better than French ones, even in the higher price ranges.



France's noisy anti-Americanism suggests that France is a reluctant participant in the global economy. But half the companies in France's top 20—such as Total, AXA, Bouygues, Carrefour, Saint Gobain, Renault, PSA Peugeot Citroën and Sanofi-Aventis—are world leaders in their sectors. Most do the bulk of their business outside France. But this does not prove that France is doing as well as it might in global business. A new McKinsey study shows that the country's share of world trade in manufactured goods fell from 6.1% in 1995 to 5.1% in 2004. Germany is doing a lot better: its companies have 6.1% of the American market, against France's 2.6%, and 8.6% of the Chinese market, compared with France's 2.2%.

Things started to go wrong for France in the mid-1990s. According to McKinsey, average annual productivity growth in 1995-2003 was only 2.1%, half the rate in 1990-95. Over the same period employment in industry fell by 5%, margins slipped by 12% and investment was down 27%. One explanation may be that France is not doing much offshoring. In 2003 imports from low-wage countries made up only 11% of France's total, compared with 39% for Japan, 35% for America, 24% for Germany and 15% for the EU 15.

But France itself, says Philippe Favre, the new boss of the official Invest in France agency, is growing more international. One French worker in seven works for one of the 20,000 foreign firms that have set up in the country; ten years ago it was one in 14. In 2005 alone 421 French companies were bought by foreigners for a total of €37 billion; most of them were medium-sized businesses rather than famous French names. Nearly half the investment in the leading share index, the CAC 40, is by foreign funds. One-third of France's exports are generated by foreign companies. A new generation of French managers is internationally respected; a Frenchman, Carlos Ghosn, is the most admired figure in the world car industry. GSK, an Anglo-American pharmaceuticals giant, is run by an expatriate Frenchman, Jean-Pierre Garnier. And a recent list of Europe's top ten business schools featured seven French establishments.

**Soft underbelly**

Yet beneath the upper crust of French international companies French business is inward-looking and timid. One man who worries about this is Hugues-Arnaud Mayer, chief executive of a small French company making health-care products and head of the regional-development committee of Medef, the French employers' organisation. He thinks small business is the Achilles heel of the French economy. There are only 1m small firms, less than half the number in Germany; and some 500,000 of these are really just self-employed people. Moreover, they export far less than Germany's famously outward-looking *Mittelstand* firms. "I think this explains a great deal of our trade deficit," says Mr Mayer. He thinks small businesses rely too heavily on local customers and are afraid to venture into the English-speaking world of exports.

According to the McKinsey study, French companies with fewer than 2,000 employees account for 99% of all companies, 70% of all jobs, 60% of industrial value added but only 50% of exports. Their operating margins average 7.8%, compared with 9.2% for big firms, which suggests that the corporate giants are better at coping with the pressures of global competition.

France needs more entrepreneurs like Stephane Ledoux, a fast-talking salesman in his early 30s who started work straight after leaving school at 18. Today he owns a specialist photo-processing company, Cité de l'Image, which employs 67 people at its labs on the south-western fringes of Paris. Mr Ledoux borrowed money and bought the business from a larger group for which he had been working. He considered moving the labs to low-wage Poland or Romania but quickly realised that would be counter-productive.

Cité de l'Image is a photo-processing and pre-press production house for an international clientele that runs from Guerlain and Yves Rocher to Xerox, Henkel and Air France. The work requires expensive, sophisticated equipment and highly skilled staff. Some simple work has been passed to Poland and Romania for overnight processing, but the core of the business has stayed in Paris. To cut costs, Mr Ledoux has outsourced functions such as IT and payroll processing. Last month a French private-equity group, Green Recovery, recruited him to run a much bigger business: the collection of photo agencies and image-processing firms (including famous names such as Gamma, Keystone and Jacana) that it had bought from the Hachette Filipacchi publishing group.

Medef's Mr Mayer has ideas about how to foster such entrepreneurialism. He himself used to be a middle manager at Abeil, a small health-care firm that was part of the big Suez conglomerate, until he borrowed money and bought the company. He wants the government and the financial sector to encourage more people to do likewise. For example, executives in big firms could get tax breaks to put aside capital for launching their own firm in the future. He thinks too many French managers are deterred from starting their own business by the red tape involved. He envies an online service set up by Portugal, not usually known for being the most entrepreneurial of places, that allows anyone to set up a company in 60 minutes.

Mr Mayer worries, too, about the future of the small and medium-sized companies that grew up in the post-war boom in France known as *les trente glorieuses*—the three decades of growth that ended in 1975. Many of these firms will simply fold as their founders retire. More generally, he is concerned about the law limiting working time in France to 35 hours a week. Although it has become more flexible, it is still a big handicap for French companies.

The Medef, chaired by Laurence Parisot since 2005, has transformed itself into a lobby group, particularly for small and medium-sized businesses. Ms Perisot is campaigning to improve industrial relations, which took a turn for the worse with the introduction of the 35-hour week. She wants further relaxation in the law to make it more flexible for small companies. Tax changes have already made France more attractive to venture capitalists and private-equity firms: it has just shot up from tenth to second place, behind Ireland, in the list of good companies to invest in compiled by the European Venture Capital Association. That is a good start. ■