Luxury Retail's Evolving Landscape

Executive Summary

The luxury goods market may appear to many as a recession-resistant industry that generates over $1 trillion in revenue, but a closer look at the figures suggests otherwise. Luxury retailers, which were growing 9% annually a year before the recession, saw sales drop on average by more than 13 percentage points from 2007 to 2009. Meanwhile, luxury manufacturers saw their revenues decline by an average of 21 percentage points.[1]

The major industry brands have since overcome their tepid performances and reported strong revenue gains, defying all signs of a turbulent market in 2011. But the recession seems to be the game changer for a range of consumer behaviors that could be magnified in the coming days. And these changes could potentially redefine the business model of the successful luxury retailer over the near term.

With the advent of social media, the rise of emerging markets and a refined and informed generation of millennial consumers, the meaning of luxury is blurring. It is no longer sufficient for a product to exhibit rarity. Luxury products needs to exhibit uniqueness coupled with product superiority and originality, providing value for money in today's frugality-minded reset economy.

This paper focuses on how the movement of the industry's target segment from classes to masses is affecting the luxury market and the imperatives for retailers that wish to maintain or gain market share.

Spanning the Globe

Consensus opinion of economic experts suggests that Europe is slowly sliding back into recession. However, the revenues of retailers in this region have been fueled by tourists from Asia and China who shop in Europe to purchase high-end brands at lower prices. The U.S. appears to be recovering a bit faster. In the luxury segment, product categories such as shoes, apparel and leather are fast regaining momentum in the U.S. The market for luxury goods in Japan, meanwhile, has eroded since 2007 (showing a 3% decline in revenue), mainly due to a demographic shift.[2] The reason: luxury consumers from the '90s are either retiring or becoming more conservative (due to a two-decade-long recession), thus leading to a reduction in luxury spending.

One of the fallouts of the financial crisis is the fact that APAC is gaining significant relevance as a result of the rising incomes of affluent households. China has emerged as the clear winner in terms of growth for luxury items, mainly due to a rising middle class that has exhibited a demand for "aspirational" products. A big allure for luxury retailers has been the wealth accumulation in China. In fact, wealth has slowly percolated from China's large coastal cities to smaller cities in the north and west. The luxury market in these regions is concentrated in menswear and business gifts.

The idea of luxury arose from product attributes such as rarity, craftsmanship and exclusivity to the individual. Most clothing, jewelry and acces-

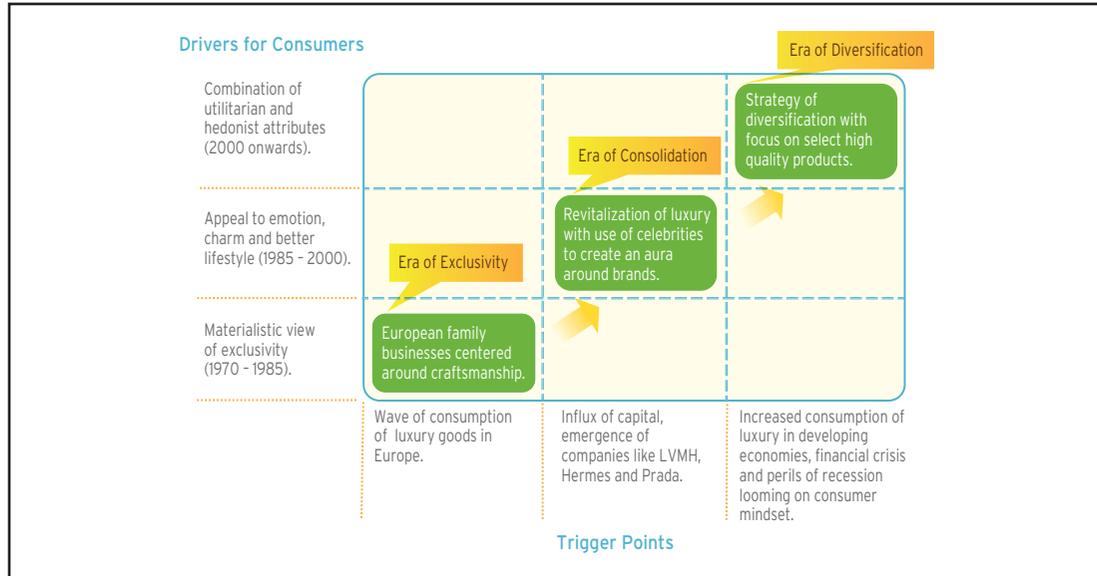Cognizant
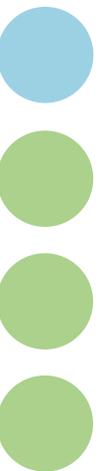
The Evolving Luxury Landscape

Figure 1

sories brands like Hermes, Louis Vuitton, Chanel and Moët-Hennessy started as small family businesses in Europe centered around creative designers.

Major European business magnates then began merging their businesses under various different umbrellas. The influx of investment banking capital led to brand marketing and an aura around product heritage and craftsmanship. Gradually the saturation of retailers' home markets in Europe and the U.S. and the emergence of developing nations like China, Russia, Hong Kong, etc. pushed retailers to enter foreign markets and diversify their product lines. Major luxury goods companies evolved from mono-brand to multi-brand. Traditionally, brands have one core segment, and additional one(s) for diversification (e.g., Armani, Bally, P.R. Lauren, Versace, E. Zegna and Choppard).

With the advent of social media, emerging markets and an evolved and informed generation of consumers, the meaning of luxury is blurring. It is no longer sufficient for a product to exhibit rarity. Uniqueness must be coupled with product superiority. Experiential luxury is beginning to gain greater market share over materialistic luxury (see Figure 3).

Traditional Luxury Consumers

The Maslow needs hierarchy[3] would be a good starting point for segmenting luxury consumers from normal buyers of day-to-day products.

Unlike ordinary purchases which are bought to solve a problem or need, luxury products are purchased for the experience, by consumers seeking self-esteem (self-actualization). It is not essential for survival but related to status, ego and psychogenic needs.

The purchase of a luxury product provides the consumer with greater joy and satisfaction than the economic value of the product itself. This utility could be derived either through the selection process, the purchase experience, use of the product or the pride derived from owning the product. Luxury products are timeless classics which generally don't go out of style. They have high recall value and exclusivity.

The New Luxury Consumers

The new luxury consumers are younger, better informed, more exposed globally and hence more sophisticated. A large portion of these consumers are baby boomers[4] who want to define their own rules. These consumers are less materialistic and more experiential.

A second set of consumers are generation X and Y[5] who aspire to own these products. They save in order to buy the best or take a short-cut (counterfeit products) to gain status. These sets of people believe luxury is for everyone but different for everyone. These consumers are driven by the need to buy and display. They believe luxury is a means of expression of status.

The consumer attitudes that influence the two segments are, respectively:

1. A personal experience that is customized to accelerate the "feel-good" factor.

2. Being part of the elite group for the aspirational class (e.g., products that transfer brand personality to the owner).

A recent study contends that emotional factors account for as much as 70% of the decision to purchase, with the balance based on rational factors such as category attributes.[6] Building brand credibility is crucial to influencing perceived value. Brand loyalty in luxury parlance is the contract between the retailer and the consumer, bonded by emotions that are difficult to replace.

Key Trends

To address the needs of a diverse audience, luxury marketers cannot rely solely on their brand

The New Luxury

Affluent consumer survey:
shopping behaviors I'm doing more often compared to last year.

	2010	2011
Using coupons/direct offers.	32%	39%
Waiting for items I buy to go on sale.	31%	38%
Buying less expensive brands than I usually do.	17%	20%
I believe that the brands I wear say a lot about who I am.	First Quarter 2008 — 51%	First Quarter 2011 — 41%
I am willing to spend more for designer brands because they are the most stylish and fashionable.	51%	32%

Source: Harrison Group and American Express Publishing
Figure 2

image. They need to give consumers a reason to believe it is worth owning the product.

Luxury markets are at a key inflection point. Post-recession, with the exception of a few leading brands, most of the smaller brands face financial stagnation or decline. As illustrated in Figure 2, consumers are becoming a bit more price-conscious, seeking higher exclusivity from the luxury brands they purchase. Consumers are becoming aware and vocal about their luxury brands' sources of origin, positioning and brand value. It therefore is becoming all the more important for luxury retailers to provide best-in-class service and create substantial brand loyalty/affinity with the consumer. For luxury brands it is extremely important to build a global footprint extending their reach deep into growing markets such as China and Russia.

The critical success factors for luxury retailers in the days to come include:

• Managing the portfolio will be the key: Strategic focus on the right category of products.

• Ride the emerging markets wave: Countries such as China, India and Russia provide ample growth.

• "Channel-ize" efforts to engage consumers: Engage customers through e-commerce, m-commerce and social networks.

• Eliminate counterfeits: Roughly 7% (worth $6 billion) of the entire world's production is counterfeit. Educate customers on brand heritage and create awareness that products cannot be substituted.

• Technology-enabled creativity and advanced functionality: Use technology to provide superior customer experience.
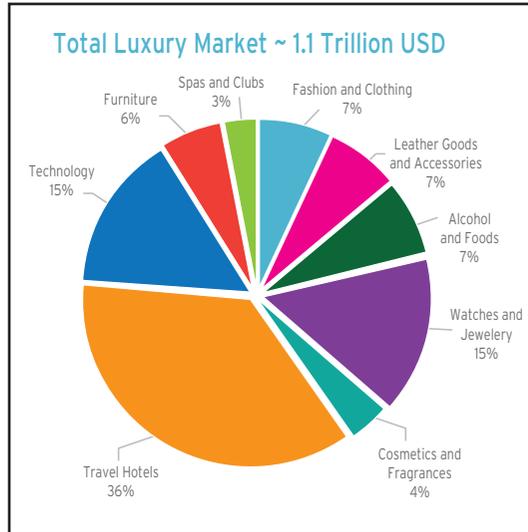
Portfolio Management

Luxury product players typically own a portfolio of various brands across different categories. The traditional categories include watches, jewelry, fashion, clothing, electronic gizmos and alcoholic beverages. According to a survey by Boston Consulting Group (BCG), these categories

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Luxury Market by Category

Total Luxury Market ~ 1.1 Trillion USD

Furniture 6%

Spas and Clubs 3%

Fashion and Clothing 7%

Leather Goods and Accessories 7%

Technology 15%

Alcohol and Foods 7%

Watches and Jewelery 15%

Travel Hotels 36%

Cosmetics and Fragrances 4%

Source: Boston Consulting Group
Figure 3

> **Post-recession, luxury goods makers have two options: either strengthen their business vertically across different product categories or horizontally across price segments.**

(including travel, hotels, food, beverages and spas) represent a target market of $1.1 trillion USD[7] (see Figure 3).

Brands continue to be the backbone of luxury businesses worldwide. Post-recession, luxury goods makers have two options: either strengthen their business vertically across different product categories or horizontally across price segments.

Merchants, planners or buyers should be on a constant lookout for new, emerging brands. Success will be determined by balancing the right mix of brands within well-managed costs. Top luxury retailers are eyeing emerging Asian brands. For example, a $650 million private equity fund backed by LVMH Group is on the prowl for up-and-coming Asian brands in the hope of transforming them into global names. L Capital Asia fund has, so far, spent a total of $90 million on minority stakes in two Singaporean fashion companies and a Hong Kong-listed watch and jewelry company. This suggests that large retailers are using their knowledge to connect and experience building luxury brands, or make the brands aspirational, to accelerate profitable growth.[8]

Among the product categories, leather goods and ready-to-wear goods have the greatest operating margins.[9]

Cutting prices would not make much sense in light of most luxury brand strategies, as price elasticity for most retailers is extremely limited and such cuts would hardly be rewarded with higher demand (since luxury goods consumers are historically less price conscious than other demographics are). However, retailers can have clearly demarcated product ranges addressing various consumer segments. Swatch is one of the few companies that has successfully expanded vertically across different price segments rather than horizontally across different luxury product categories. It sells watches ranging from the very expensive (i.e., Omega) to the inexpensive namesake Swatch brand.

Emerging Luxury Markets: China

Economies like China were least affected by recession and are taking big strides to becoming the next economic superpower. China is expected to become the biggest luxury goods market worldwide within the next four years, and it will consume 44% of the luxury market by 2020.

The greatest growth in the years ahead will originate from the upper-middle class, rather than wealthy consumers. According to a study from McKinsey, this segment accounts for about 12% of the market, and its numbers are growing rapidly. By 2015 there could be 76 million households in the income range (10,000-20,000 renminbi), accounting for 22% of luxury-goods purchases.[10] Studies also indicate that the majority of the luxury consumers in China are male and in their 30s.

These new generation shoppers are most likely to splurge on experiential activities such as spas and travel rather than traditional products such as handbags, jewelry, fashion, etc. Twenty percent of Chinese consumers will spend more on "experiences" (i.e., spas, massages and other wellness activities) whereas only 13% will spend on products.[11]

Luxury retailers in this market need to pay attention to the following:

- Most consumers would rather shop in regions like Europe and Hong Kong rather than on mainland China. Retailers must create sufficient brand visibility in major Chinese tourist hot spots.

Asia's Growing Luxury Market
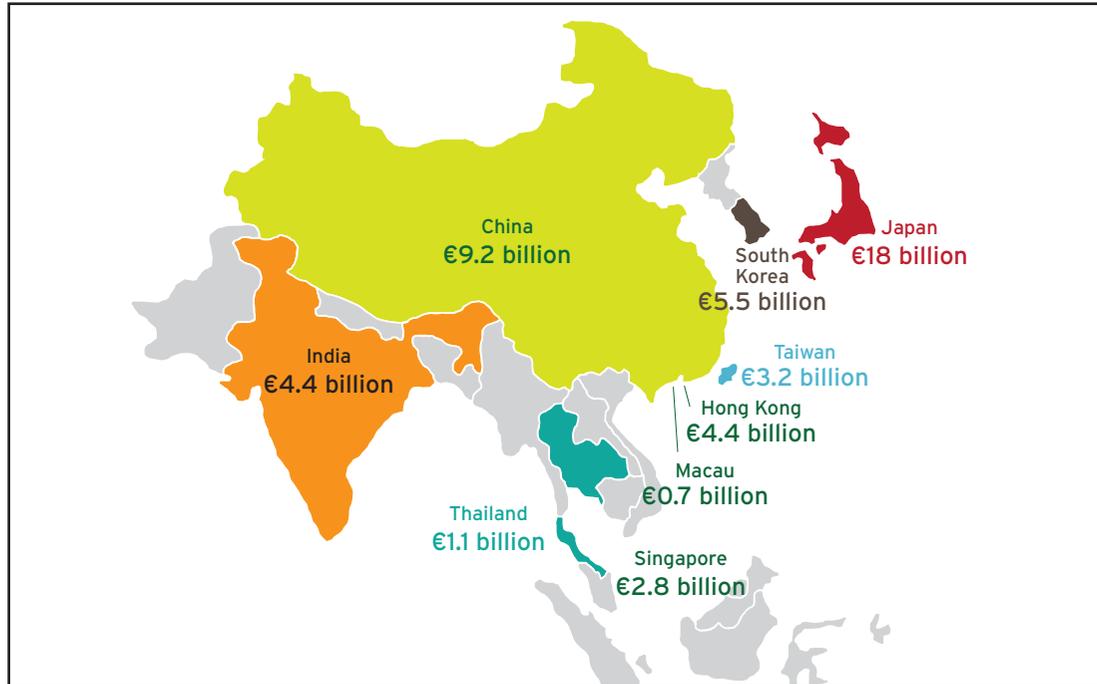
Note: Estimated 2010 revenues
Source: Bain Luxury Study
Figure 4

- Brands have a low recall value which could be a boon to mid-tier luxury retailers but a bane to established top-tier luxury retailers that cannot take for granted that their brand image will carry over. Luxury products is more of a pull than a push industry; hence, large amounts of money need to be invested in advertising and creating brand awareness.

- With more and more luxury retailers eyeing this lucrative market, the competition is cutthroat. To differentiate themselves, products sold by luxury retailers should exhibit Chinese heritage and be designed to specifically reflect Chinese culture.

Channel Optimization

A recent survey indicated that four out of five affluent luxury shoppers logged online in the past three months from their desktop or laptop computer to make a purchase, shop for a gift or research a product or service.[12] Turnover of high-end luxury brands via online shopping market reached a record high 10.73 billion yuan (68% growth) or $1.59 billion in 2011.[13]

Luxury Institute research on the wealthy consumer use of mobile devices shows that 76% compare prices via mobile devices, while a rapidly growing 27% have bought via a mobile device. In addition, 21% report that they use mobile devices to look up respective product information while shopping in stores.[14]

Many luxury companies have slowly begun to embrace online and mobile channels. However, online/mobile channels can never be a substitute for the shopping experience delivered via the retail store, where physical-world ambience and aesthetics, as well as the tactile characteristics of the product, can help make the sale. The online channel, however, can complement the physical store and influence "connected shoppers" to visit the store. Retailers can use this channel to educate consumers on brand heritage and exclusivity.

For a luxury retailer, brand integrity, exclusivity and value, outstanding service, convenience, security, an appropriate degree of personalization and consistency are mandatory attributes of each and every channel.

Among luxury retailers, Nordstrom has consistently excelled in engaging customers with its cross-channel strategy. It has consistently linked social media with innovative visuals and up-to-date search pages to create a "wow" factor

among its audience. Ralph Lauren has embraced digital marketing using virtual fashion shows and interactive store windows to engage customers.

The following should be applied by luxury retailers to create a successful cross-channel presence:

- Use strong video content to provide a more exciting and engaging shopping experience.
- Encourage customers to engage in product feedback/ratings.
- Provide detailed product description pages with 360-degree views to facilitate the sense of "touch and feel."
- Integrate the Website with Facebook and Twitter pages.
- Offer suitable smartphone apps; this is something affluent consumers have a strong affinity for.

Countering Counterfeits

Worldwide, it is estimated that counterfeiting accounts for 5% to 7% of world trade. Nearly one-third of all counterfeit sales are now Internet based. The global luxury industry loses $250 billion annually to counterfeit goods.[15] China is responsible for the production of approximately 85% of counterfeit luxury items (most of which are exported). When referring to counterfeits, it is generally assumed that copied products not only ruin the special status aspect of the original but also contribute to a severe loss in exclusivity and uniqueness due to the availability of lower-priced fakes.

Here are a few tips to luxury retailers that can break the vicious circle of counterfeits:

- In most countries, consumers purchasing fake products have found that filing complaints with the vendors was not successful. There is no channel to authenticate the genuineness of products. Boutiques selling luxury goods typically refuse to certify the authenticity of luxury goods. Government agencies can only examine the quality and ingredients of products, rather than their authenticity. Luxury companies must look to certify the authenticity of their products similar to expensive commodities such as gold.
- The French luxury sector has succeeded in lobbying for domestic legislation against not only trading in counterfeits but also in using and possessing them. If anyone is found with a fake luxury product, he/she risks going to jail for up to three years; the law doesn't care

how the product was received. Other countries must try to follow suit.

- Brands such as Kate Spade and Louis Vuitton typically hire private investigators to find where counterfeits of their brands are sold. They also have their lawyer send a threatening letter in the hope that it will scare counterfeiters into shutting down their operations. They also try to convince authorities to take action against these counterfeiters.
- LVMH Group has been battling fake product makers for years using a buzz strategy created through the combination of aspirational ads with famous attention-grabbing artists, corporate sponsorships (LVMH Young Artists' Award, LVMH Discovery and Education), VIP events (Louis Vuitton Classic, Louis Vuitton Cup) and PR activities. The most attention-grabbing event has been its highly priced and heavily promoted seasonal limited-edition bags. These fashion bags truly create an aura of exclusivity and pride to the owners, thus discouraging consumers from purchasing fake products.

Technology-Enabled Creativity

Technology is making luxury more accessible and helping consumers who might be hesitant to enter a store experience luxury products in the comfort of their homes. Luxury companies are using technology to target Millennials[16] who enjoy using gadgets and technology. Technology usage is all about increasing customer touch points and providing a unique experience.

The following technology innovations adopted by luxury companies are worth considering:

- **Augmented reality is enabling luxury brands to introduce new product lines and promote events with nominal costs.** For example, Tissot's augmented reality campaign was more successful than any other marketing initiative the brand had conducted in the UK; sales in the Tissot Selfridges boutique rose 83%.[17]
- **In-store iPad app to supplement the sales associate.** This app should offer interactive services to address the consumer's needs, attributes and preferences. Clinique has developed the iPad Skin Diagnostic Tool to offer boutique customers comprehensive advice and information regarding Clinique products. Clinique reported sales increases as a result of its iPad app of up to 30%.[18] Equipping a sales associate with an iPad enriches the brand experience.

- **Predictive analytics can be used to identify patterns and profiles of the most profitable customers,** perform smart segmentations and execute automated marketing campaigns to improve sales.[19]

The return on investment for luxury companies on these types of technologies can be incredibly high, and helps in creating an aura that is unparalleled compared with traditional mainstream marketing methods such as advertising and print-based collateral.

Conclusion

Luxury brands can adopt a strategy to address the elite niche segment or offer another range of products, priced to attract the aspirational masses. To sustain growth, it is becoming imperative for brands to diversify their portfolio or expand their target segment.

The future of luxury retailers will be shaped by five important factors — brand heritage, exclusivity, customer relationship, diversifying business and expanding into high-growth markets. Creativity, differentiation, social responsibility and customer relationship are pivotal for retailers to succeed.

Footnotes

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2 "Global Luxury Goods Worldwide Market Study," 9th Edition, Bain & Co., October 2010.

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4 People born from 1946-1964.

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6 A recent study by brand and customer loyalty research firm Brand Keys.

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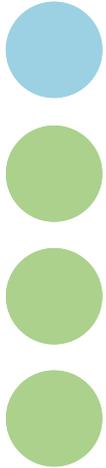
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