

Back to the Future of Luxury

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Back to the Future of Luxury

In order to discuss the future of luxury we must first understand the definition of luxury and luxury goods and examine the history and evolution of the meaning of luxury. After considering the definition of luxury and the history of luxury it seems likely that the future of luxury will be more like the past. In other words we will go “Back to the Future of Luxury”. This paper will address six aspects of the market for luxury goods:

1. Definition of luxury and luxury goods
2. Luxury Goods Market
3. History of luxury
4. Impact of the current economic crisis on the luxury market
5. Future of luxury
6. Implications for luxury marketers

1. Definition of Luxury and Luxury Goods

Webster’s dictionary notes that the derivation of the word luxury comes from the Latin word *luxus* which relates to excess. Webster’s definition includes this notion of excess but also the notion of pleasure and indulgence and the connotation of something that is not necessary. Three definitions Webster’s gives are:

- “a condition of abundance or great ease and comfort”
- “something adding to pleasure or comfort but not absolutely necessary”
- “an indulgence in something that provides pleasure, satisfaction, or ease”

When considering the term luxury and how it relates to the market for luxury goods, it is not only essential that we understand what the term luxury means, but also that we define the categories of products and services that are included in the market for luxury goods.

Let’s begin by examining the term luxury. Webster’s best definition of luxury as it applies to luxury goods is probably “adding to pleasure but not absolutely necessary”. However, if we apply this definition literally then we would create a great deal of confusion as to what is and what is not a luxury good. Taken literally, this definition gives luxury a very broad meaning. It could mean that a Latte at Starbucks is a luxury or an extra scoop of ice cream is a luxury. It could mean that a bubble bath is a luxury or an evening with friends and family is a luxury. There are many ways

to use the word luxury in describing luxury products. We have luxury watches, luxury pens and luxury jewelry. We have luxury cars and luxury yachts. Luxury cars have luxury leather upholstery and luxury sound systems. We have luxury spas, luxury car services and luxury catering services. We have luxury wine and spirits; we have luxury restaurants and hotels and which offer luxury robes, towels and sheets. The term luxury is becoming entirely over used - so much so that it is beginning to lose its meaning in describing the market for luxury goods.

The term luxury goods was popularized by Wall Street analysts who needed a term to describe companies such as LVMH, Richemont and Gucci which had become public companies. Prior to the popularizing of the term luxury goods, these companies were not really known as “luxury goods” companies but instead were known for their specific areas of expertise and the global reputation they had garnered. Chanel (1910) and Dior (1946) were known as couture fashion houses. Louis Vuitton (1853) was known for its luggage and Gucci (1906) was known for its shoes. Mont Blanc (1906) was known for pens, Cartier (1847) for jewelry, Rolex (1908) for watches, and Hermes (1837) for leather goods. Burberry (1856) was known for its rain coats, Baccarat (1764) for crystal and Christofle (1830) for silver.

Eight Distinct Qualities

All of these brands and products share most if not all of eight distinct qualities:

1. Family Owned for generations
2. Extraordinary creativity and design
3. Proprietary “savoir faire”
4. Made by hand
5. Exceptional Quality
6. Rare or Very Limited in Availability
7. Purchased by the world’s most discerning clientele
8. Extremely expensive

The Three* Essential Qualities of a Luxury Product

The qualities listed above can be distilled into three comprehensive attributes that all luxury goods must possess:

1. Extraordinary creativity and design
2. Exceptional Materials and Quality
3. Rare and Extremely Expensive

These qualities constitute the litmus test for any brand, product or service that wants to be considered a luxury product or service.

*** Outstanding Customer Service**

While not absolutely essential to being a luxury product there is one additional quality that nearly all luxury products possess which is typically considered a given and that is outstanding customer service.

2. Luxury Goods Market

There is no definitive source to determine the size of the global luxury goods market. The biggest problem is that there is no good definition of what the luxury goods market actually comprises. Estimates range from \$75 Billion to \$1 Trillion depending on what you include as a luxury good. Estimates that reach \$1 Trillion include a very wide range of products and services that can be considered luxury and generally include many categories that traditional luxury professionals do not consider as part of the luxury goods industry. These would include luxury cars, boats and jets, as well as luxury hotels, spas, and resorts. If we also included luxury homes, that would be another enormous market. Estimates include a whole host of other goods and services which are premium priced. Some "experts" even suggest that Starbucks is a luxury good because it is a premium priced product. The global market for traditional luxury goods (as described below) is probably in the range of \$150-\$200 billion.

When Wall Street analysts began following the stocks of several luxury goods companies, the products they marketed became the *defacto* definition of luxury goods. The leading luxury goods companies have reasonably different product mixes but generally participate in five or six well defined categories that include fashion, jewelry, leather goods and accessories, and fragrance and cosmetics. LVMH is the largest luxury goods company by far with 2007 revenues of over \$16 Billion Euros. Their business segments include Fashion and Leather Goods, Wines and Spirits, Perfume & Cosmetics, Watches and Jewelry and Selective Retailing. Richemont defines their business units as Jewelry, Watches, Writing Instruments and Leather and Accessories. Bulgari lists their business categories as Jewels, Watches, Accessories, Gifts and Fragrances and just recently Hotels and Resorts. Tiffany lists their categories as Jewelry, Time Pieces and Tableware. Hermes lists their categories as Silk and Textiles, Leather Goods and Saddlery, and Ready to Wear and Fashion Accessories. All of these traditional luxury goods companies

participate in the same categories to a greater or lesser extent. The one exception is that LVMH has a large business in wines and spirits

Broadly speaking there would probably be general consensus amongst analysts and traditional luxury goods companies that there are **three principle luxury goods segments**:

- Fashion and Accessories (hand bags, shoes, scarves and ties, sunglasses, etc.)
- Jewelry and Watches
- Fragrances and Cosmetics.

Other generally accepted luxury categories include:

- Writing Instruments – i.e. Mont Blanc, Dupont, Monte Grappe, Waterman
- Table Top – i.e. Christofle, Baccarat and Bernardaud
- Decorative Arts – i.e. Lalique and Daum

While these other categories are accepted as luxury goods, all of them combined are small compared to fashion or jewelry. One aspect these categories have in common is that they are all durable goods with the exception of fragrance and cosmetics and wines and spirits.

Non-durable goods which may be considered luxury goods include:

- High end wines, champagne and spirits
- Premium Cigars
- Gourmet foods such as caviar, foie gras and chocolates

Very few gourmet food brands rise to the level of luxury brand status. Examples would include Petrossian and Fauchon.

Luxury retailers such as Neiman Marcus, Saks Fifth Avenue, Galleries Lafayette and Harrods have luxury brand names themselves but as they primarily sell other luxury brands they should really be considered luxury retailers and not a luxury goods brand. In determining the size of the luxury market one question to consider is whether or not the sales of the luxury retailers should be included in the size of the market. It would be a mistake to count the entire sales of the retailers together with the brands as it would be double counting. Another consideration when estimating the size of the market is retail sales vs. wholesale sales. As most all luxury brands are also retailers their revenues are a blend of wholesale and retail.

The definition of the luxury goods market described above leaves several huge business categories which have “luxury” or premium priced offerings such as luxury cars, boats and planes. Other categories which are not included offer luxury experiences or services such as hotels, restaurants, resorts and spas. Obviously all of these goods and services are purchased and appreciated by luxury goods consumers but they are not generally considered to be part of the traditional market for luxury goods. This notion may change as the traditional luxury goods brands expand into different categories.

Over the past 10-15 years all luxury brands have been expanding horizontally into different traditional luxury categories. To list a few examples - Louis Vuitton has expanded into fashion, jewelry and watches. Mont Blanc has expanded into watches and jewelry and Bulgari has expanded into fragrances and accessories. Now we see Bulgari expanding into a non-traditional luxury goods category with the opening of hotels. Obviously since the revenues from their hotel group will be consolidated into their results it expands the definition of luxury goods for Bulgari. There have been other designer extensions into other non-traditional luxury categories – for example there is a Giorgio Armani branded cell phone. Armani and others have also expanded into home linens and accessories. These examples beg the question of what is the proper distinction between what is luxury, and what is a luxury good. Increasingly we are seeing that luxury goods create luxury brands which define luxury goods based on their categories of participation. In the future it is likely that we will see further expansion of the major luxury brands into additional categories. These brands will have to be careful to avoid over extending their brands’ core strength into categories in which their brand does not have strong credibility. Luxury casinos such as The Wynn or the Bellagio deliver luxury services but should they be considered part of the luxury goods category? What if LVMH bought the Bellagio? That would create a new debate about the definition. In which categories will luxury brands be legitimate? What if Giorgio Armani licensed an ice cream? Or Gucci marketed chocolate. Would these extensions be accretive or dilutive to the brand’s equity? Pierre Cardin is perhaps the best example of a luxury name that was licensed to a vast array of categories that were not necessarily luxury. The conventional wisdom was that this ruined his luxury cache. If the definition of luxury is expanded too broadly it devalues the concept of luxury.

3. Historical Context of Luxury

In contemplating the future of luxury it is important to understand the historical context of luxury. An evaluation of how the definition of luxury has changed over the years can be informative to how we view luxury today . For this discussion let’s combine Webster’s definition of luxury with

two of the essential qualities of a luxury discussed above. We will therefore say that a luxury product is:

“An unnecessary and extremely expensive indulgence that provides pleasure because of its exceptional quality and beauty”

If we accept this notion then by definition luxury products are unnecessary and extremely expensive. Some categories of luxury items have stood the test of time – literally. Watches for example have always had the utilitarian purpose of providing time. However, discerning consumers have sought luxury watches based on beautiful design, sophisticated movements and adorned with jewels and of course these were not only beautiful but also very expensive. Jewelry is quintessentially a luxury good being both unnecessary and extremely expensive. Automobiles were originally a utilitarian improvement over the horse and buggy but from the early days luxury cars were produced that provided other aesthetic and luxury features. A car may have become a necessity, but a luxury car is not necessary and is extremely expensive. Transportation has always had a luxury component from ornate carriages to luxury train cars, to luxury automobiles. With the advent of aviation came first class travel and now private jets. High end fashion may change with the times but the notion of luxury clothing has not. Expensive leather luggage is nice but certainly unnecessary. Another luxury that continues today is the luxury home. The wealthy have always had luxurious homes. So in many respects what was viewed as luxury in the past is still seen as luxury today.

Probably the biggest difference between luxury in today's world and luxury in the past is the relative disappearance of custom or bespoke products. In the 18th and 19th centuries much of what was considered luxury was custom made. The wealthy class purchased custom clothing, had jewelry made to their specifications and even had custom fragrances created for themselves. Today most luxury goods are produced and sold. There are still custom clothiers, shirt makers and boot makers but the common notion of custom made has essentially vanished. This has meant the disappearance for the vast majority of local watch makers and jewelers, custom dress and shirt makers and other custom made products. The major luxury brands have now captured the lion's share of business amongst luxury consumers around the world.

Over the past 20-30 years major luxury brands have grown very significantly in three ways. First of all they have significantly expanded beyond their borders and have become truly global brands. As part of this expansion they became retailers of their own products rather than simply distributing their goods through other retailers. Finally, as discussed previously, they have expanded their brands horizontally across a wide range of product categories where they

previously had no presence. As a result some brands have grown ten fold or more. As these luxury brands have expanded they have become tremendous marketing machines. They have grown their traditional consumer base by offering a number of lower priced items to appeal to a wider audience. Fragrance was the first vehicle for the “democratization of luxury”. The best example being that while millions could never afford a Chanel gown or even a Chanel handbag, they could afford a bottle of Chanel Number 5. Other accessible categories now offered include small leather goods, writing instruments, silk ties and scarves and sunglasses - all having price points under \$500.

As the luxury brands grew and their market valuations grew it created an incredible thirst for marketers to create or relaunch luxury brands. Two of the best examples of turn arounds are Gucci and Burberrys but there are many more. The huge valuation multiples accorded to luxury brands also enticed many brands to try and reposition themselves to be luxury brands. Brands such as Coach and Bally hired new designers, rebranded themselves and opened stores in luxury malls and luxury shopping avenues. Brands like these helped foster the concept of “affordable luxury”. Any brand that was of top quality or was premium priced tried to position itself as a luxury brand. The simple reason being, that luxury brands command premium prices not only in the market place, but also in the stock market.

4. The Impact of the Current Economic Crisis

In his 1958 classic, The Affluent Society, Harvard Economist John Kenneth Galbraith made the argument that society as a whole had become affluent – after all most all families had tremendous modern conveniences previously known to be luxuries such as plumbing and heating, washing machines, electric stoves and refrigerators and two cars. He argued that as society becomes relatively more affluent, private business must "create" consumer wants through advertising to create an artificial demand for products beyond the individual's basic needs. Given today's economic crisis, it is hard to argue with this principle which he wrote about 50 years ago. This is a particularly relevant concept for luxury goods – especially if we accept the notion that luxury goods are by definition unnecessary and extremely expensive.

As our review of the historical context of luxury suggests, in many respects the notion of what is luxury has not changed so much over time. However, the affluence that Galbraith wrote about has continued to increase across society. Affluent luxuries such as heating, plumbing and electricity have been augmented by air conditioning, color (and then cable and then satellite) TV's, computers and the internet. But in addition to this utilitarian affluence, over the past 50 years the Affluent Society really has become very affluent in wealth and in the number of wealthy.

Despite the fact that there is a growing gap between rich and poor, there has been enormous wealth created in this country and around the world over the past 50 years. There are nearly three million households in the US alone with a liquid net worth of over \$1 million and there are literally tens of millions of households that have the buying power to purchase luxury goods from \$500 - \$5000. The disposable income households have to spend has been greatly enhanced by huge gains in the stock market and huge gains in the value of houses. But disposable income is not limited to gains in the stock market or house prices, it is also the result of the enormous growth in the American service economy and can also be attributed to the advent of dual income families. The result is that the majority of luxury goods products have become affordable to a much larger segment of the population. Louis Vuitton or Gucci hand bags are still relatively very expensive but never the less very affordable for millions of consumers.

One of the phenomenon's (and attractions) of marketing luxury goods is the relative ease luxury brands have in convincing consumers to spend vast sums of money on things they simply don't need! No matter how high the price, luxury consumers are typically very happy with their purchases even though they logically know that the cost of the item is far too high for its utilitarian worth. Luxury brands appeal to the visceral side of consumers. Advertising and promotional hype from the red carpet of Hollywood or the pages of glossy magazines are indisputably creating the demand or "wants" for these products much as Galbraith suggested. In the case of most consumer products, advertising creates a relative desire for a given product but that product typically has a utilitarian function such as cleaning your teeth or washing your clothes. The price paid is generally a market price that reflects the cost and value of the product.

Luxury goods, while sometimes having a utilitarian function such as clothes or shoes do not have a price which reflects their intrinsic cost or added value they provide – certainly not in comparison to an ordinary pair of shoes or an inexpensive handbag. The mark-ups on some luxury products is sometimes eight to ten fold. The price is irrational and is justified based on its uniqueness or creativity and its rarity. Luxury goods are typically of exceptional quality, but the prices charged to consumers are at a huge premium over cost. As luxury brands have dramatically increased their production quantities and sent manufacturing for many items to the orient, the prices have been reduced in some cases. The combination of greater availability, greater affordability and in some cases diminished quality threatens the luxury status of many brands. If the notion of being extremely expensive is a defining component of being a luxury good, then affordability is another measure of a luxury good. If a brand becomes affordable to a large market then it brings into question its status as a luxury brand. If a luxury brand is too broadly available then it no longer is rare, which is one of the defining components of a luxury brand. In other words the tremendous success and expansion of some luxury brands may threaten their own status as a luxury brand.

Over the past 15-20 years the market for luxury goods has exploded due to the global expansion of luxury brands and the dramatic increase in consumer wealth. The current economic crisis is unlike anything we have ever experienced and will have profound effects on the luxury business. In the past, recessions did not dramatically affect the consumption patterns for luxury goods. The reason was because the truly wealthy were unaffected by the recession and so it did not have a dramatic affect on their luxury goods consumption. The last significant recession was in the early 90's. In fact it was a pretty mild recession. The difference at the time was it was the first white collar recession. This was more a reflection of how much the economy had changed from manufacturing to services. At the time the global luxury goods business was just beginning its huge phase of growth. The luxury goods business grew tremendously throughout the nineties and was then hurt dramatically by a series of events at the arrival of the new millennium including the bursting of the dot com bubble, 9/11 and Sars. Never the less the market for luxury goods quickly recovered as stock markets recovered, the run up in housing prices began and the arrival of new luxury markets emerged in Russia, China and the Middle East.

The current recession is profoundly different and will affect the luxury goods business in dramatic ways for many years to come. First of all since the audience for luxury goods has expanded so extensively, the recession will impact a much larger base of luxury consumers than ever before. In other words not all luxury consumers are rich and the new aspirational luxury consumer will be severely impacted by the recession. In the US 2.7 Million households have liquid net worth of \$1 million or more and 2.5 Million households earn over \$250,000 per year. These groups constitute the core of the luxury consumer. But there is another huge group of 23 million households with annual income of over \$100,000. This group of near wealthy which has helped fuel significant additional demand for luxury goods will be severely impacted by the recession. As this group holds back on unnecessary expenditures in favor of personal savings, luxury purchases will become unaffordable to many.

The expansion of the luxury consumer base has helped grow the luxury market to new heights and this means that the luxury brands now have further to fall than ever before. The recession's impact on these newer luxury consumers is already a cause for great concern. However, of even greater concern to luxury marketers is the fact that this is not merely a recession. The melt down in the financial markets means that the core luxury consumer – the truly wealthy - has lost very significant wealth. Compounding this problem is that the near wealthy who have become luxury consumers have also lost great wealth in the value of their homes. Not only the disposable income but also the wealth of the entire consumer base of luxury customers has been rocked. This is already leading to a significant drop in sales. Neiman Marcus - a bell weather company in

luxury goods retail -announced a drop of over 31% in December. That compares to a drop of 2.7% across all retail which was considered the worst December in over 25 years.

The impact of the recession and the loss of wealth will have severe and profound affects on the luxury business. Essentially all luxury goods purchases are by definition unnecessary and therefore can be eliminated. In addition the luxury goods business has a huge travel component not only from sales of travel or duty free retail stores in airports, but also because major luxury goods boutiques are found in the major cities around the world. Unlike regular retail stores, luxury stores garner a significant portion of sales from tourists. Since travel is another discretionary purchase that consumers are cutting back on, it will be another drag on luxury sales.

5. The Future of Luxury

In considering the future of luxury, we must once again define what luxury is. If two of the essential components of luxury are rarity and being extremely expensive then we must realize that a significant portion of the luxury market has been cooped by global luxury brands that are highly marketed and hyped through advertising and PR. Even if these products are beautifully designed and of exceptional quality, many of their offerings are no longer always extremely expensive or very rare. The best manifestation of this is seeing these brands in the outlet malls. In that sense much of the luxury market has lost its meaning. They are no longer special and rare. There are very few brands which stand the test of having exceptional design and quality, have products which are rare or in limited supply and which are truly extremely expensive. Quintessential examples of true luxury goods brands are Hermes and Chanel. To illustrate this point when was the last time you saw a Hermes outlet store or a "take another 50% off" at a Chanel store? These brands are in limited supply, are extremely expensive and rarely if ever offer discounts.

The combination of the tremendous growth and expansion of the luxury market over the past 15-20 years coupled with the severity of the recession and the market crash means that the future of the luxury market is very likely to change. There will be a great number of specialty luxury brands who will close stores in all but a few markets. Instead of having 15-20 stores they will end up with six to eight if not three to four. Affordable luxury brands will probably no longer be thought of as luxury but merely affordable. Even some of the biggest and best luxury brands will probably rein in activities by no longer marketing products in certain product categories which are not core to their brand. Expect to see certain brands drop their watch or jewelry lines for example. Several small luxury brands will be either acquired or more likely go out of business. As a back lash to the disappearance of these niche brands, we may see the emergence of some very elite, niche

luxury companies that specialize in a single item or category but provide the highest quality to the most discerning customers. Goyard is an example of a brand that has capitalized on the proliferation of the Louis Vuitton brand. Hand made, in limited supply and very expensive makes it a true luxury brand both historically and in today's world. Many luxury malls will probably see the disappearance of one of their two or three luxury anchors. In other words between Neiman's, Nordstrom's or Saks only one may survive in a given market, especially if it is too small a market or is already over saturated.

6. Implications for Luxury Marketers

In order to survive and ultimately thrive, the very best luxury companies will need to change the way they serve their very best luxury customers. For their very best customers they will need to offer products and services which are only available to the very best customers. They will need to offer more custom solutions much like was offered in the past. They will in essence have to go "Back to the Future". There are difficulties for any business that grows from a small business to a big business. There are growing pains of course and one of the most obvious and poignant growing pains for a luxury brand or retailer is the first hand touch or involvement of management and the special attention given to the very best customers. The hallmark of great retailers like Neiman Marcus and Nordstrom is their incredible customer service. Their loyalty programs have helped foster additional loyalty from customers who can earn double or occasionally triple points and are showered with rewards and benefits. These best customers receive special catalogs, invitations to pre-sales, special events and cocktails. They are followed and serviced by personal shoppers and in general well looked after. The problem is that with the proliferation of luxury brands which have their own retail stores, their own cocktail parties and their own special events there are so many special events that they just are not that special any more.

The competition to serve all these special customers has become especially intense and collectively we have watered down the notion of "special" from how we treat our very best customers and often allowed these same "special" benefits to be given to the new masses of luxury customers. For example major luxury retailers often sponsor events which are open to all customers - whether they spend \$1000 or \$100,000. Are the very best luxury brands doing enough for their very best customers? Luxury brands and retailers need to question themselves on how they are servicing their very best customers. If a consumer spends 10 times as much doesn't that imply that we should be doing 10 times as much for them? This is a real challenge for luxury marketers and retailers but it is also a real opportunity. Luxury marketers need to challenge themselves to take customer service for their very best customers to a whole new level.

Jack Mitchell's influential book, "Hug Your Customer", points to how special customer service can and should be. The Mitchell's stores in Westport and Greenwich, Connecticut are models of customer service. As successful as the Mitchells are – and they are very successful – they only have two stores. How does a global brand or national retailer provide special attention to their most elite customers? The answer is a combination of technology -data mining - and old fashioned high touch, personal service.

A few years ago I wrote about the 5/50 rule. This is the relatively universal concept that in luxury goods often 5% of the customers do as much as 50% of the business. This may not be true for all brands or all categories of luxury goods, but one thing is for sure and that is that a very small percentage of customers do a very large percentage of the business. It is essential as luxury marketers that we not only have loyalty programs, but also that we have programs and services for our absolute elite best customers. We can't afford to lose them. A lot of the new luxury customers that were acquired over the past 10-15 years are going to largely disappear or will significantly curtail their purchases over the next year or two. It is critical that we ensure that the very best ones stay. The focus, challenge and the opportunity for all luxury marketers is to develop new programs and services to serve and retain their very best customers. Marketers need to realize that as the luxury market matures, the battle will increasingly be for a share of wallet of the very best consumers. Developing new and more sophisticated programs that can be executed in the form of old fashioned service will be an important differentiating factor between luxury brands. The very best luxury brands with five, six and seven figure consumers should even consider customer level profitability in evaluating service levels for these customers. Targeting and servicing our best customers makes sense in the good times, but will be critical during the current economic crisis which promises to be especially hard and long for marketers of luxury goods.