Chapter 1

Introduction

Definition and Crisis of Luxury

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Luxury has a long and fascinating history. It is apparent in artifacts from the Egyptian period of lavishness, from 1550 to 1070 B.C. Another great wave of luxurious lifestyle occurred during the Italian Renaissance, an era of great painters, sculptors, and architects during the fourteenth through sixteenth centuries A.D. This was followed by the reign of King Louis XIV of France (1638–1715), whose reign expressed an authentic French lifestyle. Then came Charles Frederick Worth (1825–1895) of Great Britain, a designer who created the concept of haute couture. Worth moved to Paris in 1846 to perfect and then commercialize his craft, holding the first fashion shows and launching the use of fashion labels. Coco Chanel (1883–1971) and Christian Dior (1905–1957) gave birth to modern fashions and ideals, marked by the rise of New York City as a luxury capital. The 1960s and 1970s then experienced the second Italian luxury revolution. Gucci and

Bernard Arnault started applying the principles of strategic management to modern luxury by building the first multibrand conglomerate, Louis Vuitton Moët Hennessey (LVMH) group. The latest chapter to this fascinating tale of luxury and high fashion is the information technology revolution, in which news about a new product spreads like wildfire and opinions on brands, products, and companies are shared at the click of a button. The story of the evolution of luxury is really about the evolution of society.

Countries evolve through various phases of luxury consumption. The first stage is deprivation, in which a country is crushed by poverty, which builds in the populace the desire to consume. As soon as the country manages to free itself from the shackles of deprivation and witness economic progress, its citizens are lured into buying luxuries that have high functional utilities, like washing machines, cars, and practical appliances. Then the wealthy and elite start buying luxury products. The third stage of development is marked by the desire of citizens to show their wealth: Mere possession is insufficient when luxury goods become a symbol of social status and bestow their owners with an aura of divinity. Then comes a stage in which most people in the nation are well-off and have sufficient resources; however, they have a need to fit in with their group. If someone is not carrying or wearing an appropriate social marker, they might find it hard to fit in with a particular group. Finally, luxury becomes a way of life. When people become used to this lifestyle, it becomes difficult for them to go back to their previous habits. Here luxury is more and more associated with personal tastes and pleasure, and not necessarily with wealth or status.

Issues of Defining Luxury

It is important to understand why certain brands are called luxury brands and what justifies the superior positioning they command. Luxury empires are not built by selling tasteful products at an exorbitant price. Luxury brands have been carefully crafted through meticulous strategies in marketing and brand building, making their mark in the consumer's subconscious and having the following main characteristics: brand strength, differentiation, exclusivity, innovation, product craftsmanship and precision, premium pricing, and high quality.

It is the differentiated quality of the material, design, and performance of a Patek Philippe watch that merits a 1,000-percent premium over a normal watch picked up from a general store. It is the craftsmanship that goes into the Kelly bag made by Hermès that justifies its exceptionally high price tag. It is only the brand strength of Louis Vuitton that can entice customers to preorder bags months in advance. It is attention to craftsmanship and nuances of details that help differentiate a luxury product.

Many misconceptions exist that surround the luxury industry: (1) Do luxury and fashion mean the same thing? (2) Does a high price imply a luxury product? and (3) Does luxury imply perfection?

Luxury and fashion do not mean the same thing; they can coexist, but that's not always the case. Until the nineteenth century, only the very privileged few could afford to keep up with changing trends. So only those who could bear the cost of luxury could afford to make and follow fashion. However, the twenty-first century consumer doesn't need to be wealthy to be fashionable; being trendy no longer needs to be costly. For example, streetwear brands produced by H&M and Zara are fashionable and affordable. Haute couture is still the trendsetter but is not the only reference anymore. Luxury products used to be seen as investments, which are not replaced that often, but now they have become more of a lifestyle choice. Many luxury houses try to release fashionable products along with their traditional luxury goods. For instance, Chanel offers fashionable products in order to keep up with the times and renew interest in their classic items.

If one pays a high price for an item, that does not mean that the product is a luxury good. Everyday products could trade up and charge a higher price. All luxury products are expensive, but not all expensive products are luxurious. This means that it is difficult to sell premium products as luxury goods—a phenomenon known as "premiumization" or "trading-up." Similarly, it is unwise to reposition a luxury brand as a premium product to extend its market. Automobile companies have tried to reposition products both ways and have failed, such as Mercedes with both the launch of the Smart car and its acquisition of Chrysler. It had to launch Maybach. In the meantime, BMW traded-up to the 6 and 7 series together with trading-down to the BMW 1-series. Toyota and Nissan, on the other hand, launched the Lexus and the Infiniti from

the very beginning. Porsche gained a significant market share with the launch of Cayenne in 2002, but in the meantime it suffered a lot of complaints from its loyal customers about the degrading of the brand image. When one pays a tidy sum to procure a luxury brand, what does he or she pay for? Perfection? Not necessarily. In some ways, what defines the luxury brands are the creators and not the consumers. A luxurious product may thus be far from perfect. However, would these characteristics be questioned in times of a recession, when consumers become more cautious, have a limited budget, and spend less?

Crisis

> *Bling is over. Red carpetry covered with rhinestones is out. I call it the new modesty.*
>
> —Karl Lagerfeld

There were several economic crises during 1970s to 2014, starting with the oil crises in 1973 and 1979, the stock market crash in 1987, the 1992 Black Wednesday crash, and 1997's Asian financial crisis. The first 10 years of the twenty-first century also saw many crises. The stock markets collapsed in early 2000, following the dot-com bubble of the late 1990s. In 2001 the world watched as the terrorist attacks in New York and Washington took place, followed by the war in Afghanistan in 2001 and the invasion of Iraq in 2003. The early 2000s also saw a recession in many countries of the world, aggravated by the outbreak of SARS in Asia in 2003. In 2004, the tsunami in Asia killed hundreds of thousands. Finally, in 2007 the subprime mortgage crisis that began in the United States housing market spread all over the world and caused, among many other things, the collapse of Lehman Brothers and the European debt crisis of 2011, which continues to have effects such as the Cyprus bailout and political turmoil in Russia and Italy.

Crisis can essentially be of four forms: (1) endogenous (inner), such as economic and financial crises; (2) exogenous (outer), such as a political crisis; (3) natural disasters; and (4) mixed characteristics. An *economic crisis*

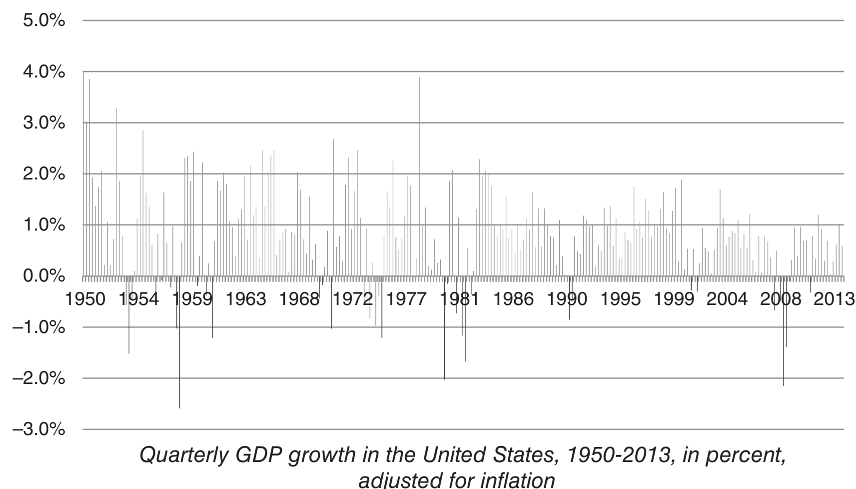

Figure 1.1 Quarterly GDP Growth in the United States, 1950–2013 (in percent adjusted for inflation)

is one where the real economy, of one country or worldwide, experiences a significant slowdown. The gross domestic product consumption stagnates or shrinks, along with investments, capacity utilization, household incomes, company profits, and inflation, while bankruptcies and unemployment rates rise. Figure 1.1 shows periods of shrinking GDP between 1950 and 2013 using the example of the world's biggest economy, the United States.

On the other hand a *financial crisis* is a sudden devaluation of assets, such as stocks or currencies, which may or may not have an effect on the real economy. In itself, a financial crisis only leads to the destruction of paper wealth. It has been observed that there is a reciprocal relationship with other types of crises, such as economic crises and political crises, which is the reason why financial crises generally lead to increased levels of caution within politics and the real economy. Examples of such financial crisis are the burst of the dot-com bubble, together with the September 11, 2001 terrorist attacks, the subprime crisis of 2007, and the ongoing Eurozone debt crisis facing the world, transforming from the private debt property bubble of 2008–2009 into the sovereign debt crisis of major banks and economies of Europe, in which the Dow Jones lost about 50 percent of its value. Other such crises that affected the

world include the South American debt crisis of the 1980s, known as the "lost decade"; the Asian financial crisis of 1997; the Russian crisis of 1998; and the European debt crisis that started in 2010 and has taken an enormous toll until the present moment.

Like financial crisis, *political crisis* may affect the economy and have an effect on industries, including the luxury industry. Examples of political crises are the Cuban Missile crisis, the Falkland crisis, the Iraqi invasion of Kuwait and the following intervention by the United States in 1990, and the terrorist attack in 2001. In 2011, the governments of Tunisia and Egypt were overthrown by revolutions and Libya saw a regime change after a civil war that was supported mainly by France and the United Kingdom. More recently in 2013, the election results of Beppe Grillo's Five Star movement in Italy combined with the EU's decision on tax issues in Cyprus have fueled disbelief in the democratic problem-solving capacity of the EU and its members.

Natural disasters such as the tsunami in Asia in 2004, the Tōhoku earthquake and tsunami that caused a meltdown at the Fukushima nuclear plant in Japan in 2011, and the typhoon Bhopa in the Philippines in 2012 had devastating effects on the local economies.

The Luxury Industry

Past crises have had different impacts on varied groups (be it luxury conglomerates or independent luxury houses) at different times; this could be attributed to the exogenous and endogenous characters of the economic cycles. Nonetheless, the 2009 financial crisis was global in nature; it ultimately evolved into the Eurozone crisis and in 2014 is still continuing to affect the major countries in both Europe and America.

To understand the effect of crisis in the luxury industry, luxury must first be divided into (1) hard luxury, such as watches and jewelry; and (2) soft luxury, such as fashion. A more comprehensive definition of the luxury industry includes products and services such as wine and spirits, food, travel, hotels and spas, technology, and cars. Among the most well-known luxury brands are Louis Vuitton, Hermès, Gucci, Cartier, Porsche, Ralph Lauren, Rolex, Tiffany, Armani, Burberry, and Ferrari. In 2012 the worldwide market for luxury grew more than 4 percent

over 2011 to a massive €212 billion. In 2013 the worldwide market for luxury grew over 2 percent over 2012 to a massive €217 billion.[1]

During 2009–2013, this industry felt the impact of the crises. Luxury consumers changed, and so did the industry, with the rise of luxury multibrand conglomerates such as LVMH of Bernard Arnault, Kering of Francois Pinault, and Richemont of Johann Rupert, which were formed by the acquisitions of traditional family-run brands. Other luxury brands (usually family-owned) that resisted being taken over by the aforementioned conglomerates also grew alongside the conglomerates. The family brands protected their brand heritage and DNA; in addition, they purchased their suppliers and integrated vertically. They focused on brand equity, investing heavily in international expansion while repurchasing franchises and licenses to gain more control over their retail operations. Figure 1.2 depicts conglomerates that have a portfolio of brands selling

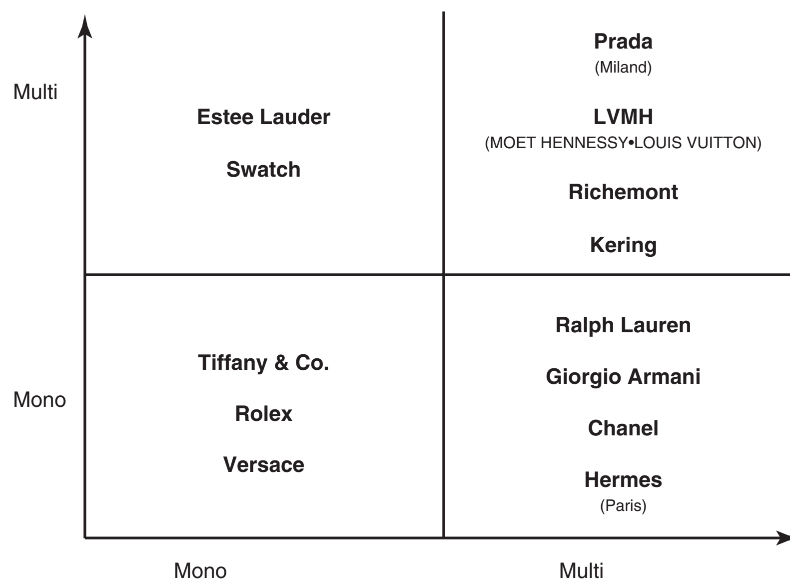

Figure 1.2 Where Conglomerates Fall in Different Brand and Product Categories

[1] Compared to the size of the luxury industry in 2014, no formal industry existed even during the 1980s. The luxury industry was an island where a happy few dwelled, unaffected by the worries of life.

different product categories (LVMH), conglomerates with many brands on one product category (Estée Lauder), companies with one brand and only one product category (Rolex), and houses with one brand with many product categories (Chanel).

Due to the oligopolistic nature of the luxury industry, there arose intense competition among the handful of competitors. The most important driver for luxury brands to succeed was, thus, dependent on the disposal income of its clientele, which translated to consumer buying power. The disposable income of high-net-worth individuals had increased during the preceding 10 years. As society become relatively more affluent, consumers with disposal income were "created" through advertising to create an artificial demand for products beyond the individual's basic needs.

Reaction to the Crisis of Global Markets

On one hand, the luxury industry is said to be recession-proof[2] due to the noncyclical nature of the industry. This belief may be attributed in part to the change of consumer behavior in the United States and the broadening of the luxury consumer base, fueled by an increase in the disposal income of high-net-worth consumers. Another argument in favor of noncyclicality was the fact that luxury customers are generally the happy few who are not affected by economic crises and continue spending at the same levels.[3] Both arguments, to a certain extent, are supported by the quick recovery of the luxury industry after the financial crises of 2001 and 2009. Figure 1.3 illustrates that over a 14-year period, the main players in the luxury industry could weather the effects of crises.

On the other hand, democratization of the luxury goods industry whereby companies created accessible products, the noncyclicality of the luxury industry, is a questionable proposition. In the recent recession that started in 2007, the picture looked grim for the luxury industry. Bain & Company estimated that the sector lost 10 percent of its revenues in

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[2]Jean-Marc Bellaiche, Antonella Mei-Pochtler, and Dorit Hanisch, 2010, 1; Jean-Noel Kapferer and Olivier Tabatoni, 2010, 11.

[3]Forbes, "Luxury Is in Crisis, Yet Luxury Brands, Tiffany's, LVHM Still Report Sales Growth," 2011.

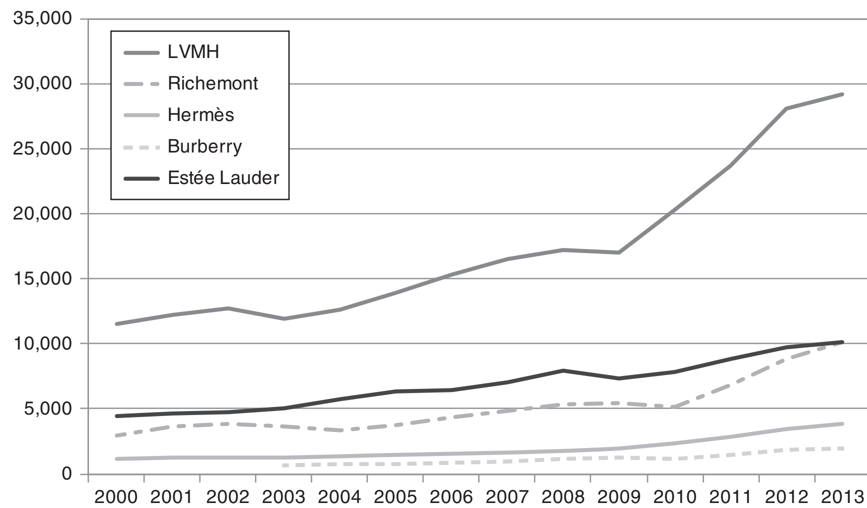

Figure 1.3 Revenues of the Main Players of the Luxury Industry, 2000–2013

2009. Reports from Bain & Company and Italian luxury goods traders Altagamma after a close watch indicated that luxury sales slumped to 5 percent in 2013 as compared to 13 percent in 2011 due to the debt crisis, which has currently gripped Europe since 2010. The growth of foreign tourism shopping in Europe slowed down to 18 percent in 2013, compared to 28 percent in 2012. Figure 1.4 depicts the effects of these two recessions, showing that the luxury firms are not immune to the slowdown in growth and revenue that follow each crisis.

The economic crisis had deeply affected the luxury world, but in a way that was somewhat predictable. For many years, the luxury brands were undergoing constant growth, and no one thought they could be affected by a world financial crisis. They thought quite the opposite, in fact. The general opinion was that these losses would soon be overshadowed by the perennial story of growth and profitability.

The sales figures from countries across the globe were interesting to observe in the light of the above discussion. In fact, the crises of 2009 and 2010–2013 helped us to better understand the luxury world. Most interesting was the behavior of consumers. Countries that were considered to be the homes and strongholds of the luxury planet were affected.

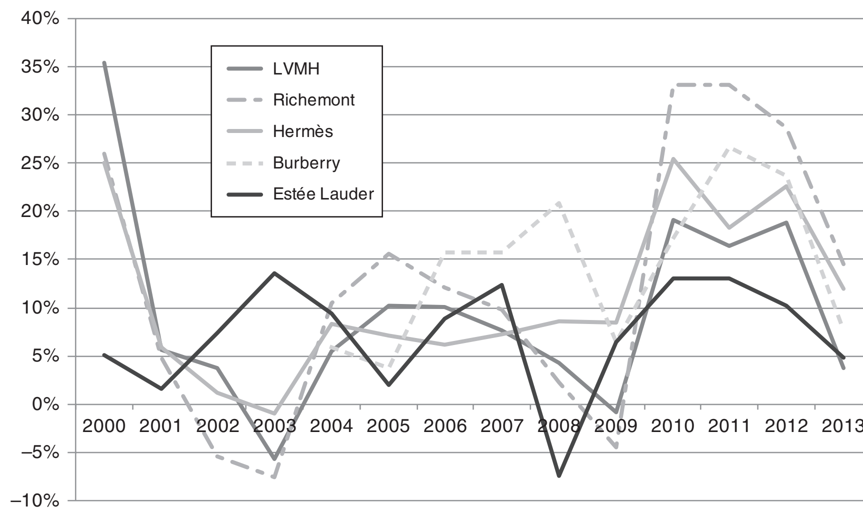

Figure 1.4 Revenues of the Main Players of the Luxury Industry as a Percentage of the Previous Year, 2000–2013

Japan

Japan was a star of luxury for 25 years, beginning in the 1980s. It represented 30 percent of sales for Hermès in 2005, at least 35–40 percent for Louis Vuitton, and up to 41 percent of the worldwide luxury goods market. Japan had been always a place where luxury shopping was considered to be an occasion. At the time of the global financial crisis, Japan represented about 50 percent of the clients of all key luxury brands. Up until 2005, luxury companies forged their futures with Japanese consumers in mind. For example, 94 percent of Japanese women in their twenties owned a Louis Vuitton handbag; 92 percent owned products from Gucci; more than 58 percent owned a Prada item, and over 51 percent possessed a product with a Chanel label on it. Traditionally, this market had been impervious to recession. Most major companies like LVMH, Hermès, Richemont, Kering, and Coach made supernormal profits in Japan until 2009. Two local crises hit the Japanese economy: the earthquake and resulting tsunami and the Fukushima nuclear meltdown.[4] Since Japan accounted for a significant share of global luxury

[4]Kelly Wetherille, 2011.

sales, the shares of LVMH, Hermès, and Burberry tumbled when the crisis hit.[5] Overall, the Japanese market retreated between 20 percent and 30 percent. LVMH witnessed declining sales by 6 percent. Salvatore Ferragamo reduced prices of its 42 items by 7 to 10 percent for the first time since it began operations in Japan. Chanel held a sale of clothes and other items. Distributors such as Seibu and Sogo merged to form Millenium, Isetan merged with Mitsukoshi, Takashimaya merged with Hankyu, and Daimaru merged with Matsuzakaya to survive. Clearly, Japan became a nightmare for most luxury brands, as consumers saw the stock market at a five-year low and hoped to reduce their consumption to prepare for rainy days in the future. For the first time in history, 2009 showed the decline of the luxury market in Japan. Given the aftermath of the tsunami and nuclear disaster that rocked Japan, it is not surprising that people did not feel like shopping.

In 2014, Japan registered between 5 to 16 percent of luxury sales. Chinese customers now account for about 15 percent of former Japanese sales. Does that mean that Japan has become a nightmare? It does not seem so. It is still, more than ever, a key market: stable, mature, and full of promise. Based on an interview about sales outlook, done by McKinsey & Co., on 20 CEOs of luxury companies who were based in Japan, 75 percent were optimistic about the future prospects of Japan's luxury market. It would have been a mistake to consider that the market was lost. For brands like Van Cleef & Arpels, Cartier, Bottega Veneta, Hermès, Prada, Chanel, and others, Japan remains a strong and vital market. It is still the world's third-largest luxury market outside Europe, after the United States and China.

Europe

During the global financial crisis, Europe—the birthplace of luxury goods—surprised everybody. Europe had witnessed 40 percent or more of all luxury sales, but after the crisis it showed its resilience, with an average decline of only 5 percent. Compared to Europe, Asia-Pacific, mainly due to China, showed a growth of 20 percent. The luxury

[5]James Topham, 2011

market in France in particular did not decline. Old Europe was again a market to cultivate during the period of financial turmoil. Brands that were present in small European cities reaped the benefit of their regional strategies. Hermès, Chanel, Louis Vuitton, Armani, and Tod's were among the companies who were not significantly affected due to their sales in Europe. This proved that Europe has been and still is the most important market for luxury, and may continue to remain so, for two reasons. First, the cultural heritage of Europe is linked to luxury. Europeans love luxury goods and have the buying power to be the most stable luxury goods consumers of the world. Second, Europe remains the number-one destination for tourists, France in particular. It meant that though the luxury business was going through the global financial crisis, the continuous flow of tourists who spend a considerable proportion of their budget buying luxury goods offset the effect of the crisis. For example, the Chinese spent nearly 1,500 euros per person annually. At the Galeries Lafayette, 60 percent of the total business came from tourists, and within this 60 percent, between 60 and 80 percent are Chinese tourists.

China

Asia overall, including Russia, China, India, Hong Kong, South Korea, and the Middle East, came to the rescue of most luxury brands after the global financial meltdown. During the recession phase, China became the winning horse that reported a growth of 20–30 percent for most luxury brands. Richemont was one brand that relied heavily on Asia Pacific consumers to help buttress its sales. The same held true for Hermès, which also sold heavily in Asia. They were saved, although the crisis affected all the actors in the luxury sector, at each level. China alone during this period could show the difference it made to the top line of a luxury company. When the distributors in the United States and Japan nearly collapsed, when Neiman Marcus reported a 20 percent decline in sales, stores in Beijing and Shanghai were reporting sales growth of up to 30 percent. Businesses in mainland China, Hong Kong, and Macau were flourishing.

China emerged as the luxury market in which to have a presence, a market that didn't exist 10 years before in 2003. China saved many

brands from sliding into the red. During this period, Kering witnessed double-digit growth in China. Richemont and Zegna, which were otherwise losing money, enjoyed healthy growth in China. Brands like YSL regretted not maintaining showrooms in mainland China. The Ferragamo family trusted Chinese women to continue demanding statement handbags, which they continued distributing despite an otherwise gloomy environment. Some brands, on the other hand, were apprehensive about the Chinese miracle. Patek Philippe was cautious with China, as it felt that the country could impose sudden import duties or levy taxes, which could destroy the business instantaneously. Despite the deepening of the European debt crisis and the slowdown of China's economic growth in 2013, China represented around a quarter of global luxury purchases.

United States

The American market represents a great untapped potential for European luxury brands, as only 17 percent of the luxury goods sold in the United States are personal luxury goods, compared to 47 percent in Italy, 25 percent in Japan, and 25 percent in China. However, it is worth noticing that the U.S. market alone drives 70 percent of Ralph Lauren's and 55 percent of Tiffany & Co.'s worldwide sales, whereas this market accounts for only 15–25 percent of the worldwide sales of most European brands such as Hermès. Moreover, it can be observed that luxury sales are high in areas with a large Latin American population due to this group's appreciation of personal luxury goods. Thus, the American market offers a promising outlook for European brands if they manage to exploit the potential.

The U.S. market over the years was always open to brands that had the capacity to invest, to persevere, and to face conflicts. It remained a difficult market that required a lot of time, energy, and resources. Luxury brands suffered in the United States. For example, Dior went in the wrong direction, running after licenses, opening everywhere, and lost money. Fred Segal, which opened in Los Angeles, could not meet its overhead costs and was acquired by LVMH. But the U.S. market has strong potential in the long run in many cities besides expensive centers such as New York, Los Angeles, and Miami. This is the reason why luxury brands should ask the question, "To be or not to be in the

United States"—Leonard Fashion answered "Not to be." They were right. Hermès, LV, Cartier, and Chanel succeeded in the United States, competing with Coach, Ralph Lauren, and Tiffany & Co. The U.S. brands had hundreds of stores, a very different tactic from the European shopping experience. Americans do not yet have the taste for luxury; they have a long way to go, and apart from two or three main cities, the interior of America is not ready to understand the French or the Italian luxury world. It will take time and effort to develop a customer base. It is, however, a market full of promise. All the factors to succeed in the United States are there. It is a stable and rich country, and the only country where a great number of women are millionaires.

Africa

The Northern African market also experienced crises. The most notable local crisis was the Egyptian revolution in 2011 and the Arab Spring. Burberry and Ferragamo stores were closed permanently, while the companies that remained open watched as sales declined up to 70 percent. One reason was that wealthy customers were the first to leave Northern Africa during the unrest. This was corroborated by the fact that the occupancy in luxury hotels such as the Four Seasons, Kempinski, Hyatt, and Sofitel dropped by 30 percent. However, due to democratization of the luxury industry, perfume sales in Africa were increasing at a rate of 25 percent, due to licenses from Gucci and Dolce & Gabbana. It has also been predicted that distributor sales for perfume will reach $100 million in the coming decade. Niche brands have started to make their mark in Africa. For example, Vlisco, a luxury textile brand from Holland engaged in textile wax, has long been successful in Ghana. Soon the entire continent of Africa will be a promising market for luxury brands.

Effect of Crisis on the Luxury Industry

The luxury world was a place where no one expected to perish. And then suddenly Christian Lacroix rang its bell—investors collapsed in the face of the coming of Louis Vuitton and Céline and were obliged to leave the company when the shareholders of Escada refused to inject the fresh capital required to turn around the company.

On the other hand, consider the resurrection of the legendary Italian haute couture house Schiaparelli, known for the introduction in the 1920s of women's shorts, colored zip fastenings, and catwalk shows. After being shut down since World War II, it was repurchased in 2009 by Diego Della Valle and relaunched in 2012. Diego Della Valle, the chairman of Tod's Group who also revived the famous brand Roger Vivier, has brought Schiaparelli back on the stage of the fashion business after more than 60 years. This is not the only case in the luxury world. The almost immortal vitality and endless potential of a luxury brand can never be compared to any other normal brands.

The crisis was a wake-up call for the luxury industry. All *métiers* were hit by the 2009 recession but not at the same level. The métiers reacted in different ways. Watches were showing the most profound weakness, decreasing in all markets to the tune of 20 percent, which scared the Swiss and most other brands. Jewelry followed with a decrease of 15 to 20 percent. *Arts de la table* fell at least 20 percent or much more. Ready-to-wear for women and men fell 10 to 20 percent depending on the brands, and even perfumes fell between 7 to 15 percent. It affected L'Oréal, Estée Lauder, Clarins, and their competitors. The most resilient were leather goods, which explains the consistency of Louis Vuitton, Goyard, Hermès, and, within the brands, Chanel, Gucci, and Dior bags and other leather goods.

Overall, the watches and jewelry segment faced a mixed reaction. While the recession was known to hit the watch industry the worst, some people still invested in the Rolex brand in times of crashing stock markets and devaluing currency. Luxury houses like LVMH were known to have fared better than the likes of Richemont, because LVMH, through TAG Heuer, invested in hard luxury versus Richemont, which focused on soft luxury. Brands like Hermès, Swatch, Chopard, Hublot, and De Beers faced declining profits, whereas Dior fared well in the watches and jewelry sector. However, industry figures depicted a decline of 31.9 percent in June 2009 and a slowdown in the summer of 2013 due to unfavorable economic climate in Europe and in China. Swiss exports of watches declined, indicating that it was an industry-wide phenomenon.

For the wines and spirits sector, brands like Diageo, Moët & Chandon, Pernod Ricard, and Rémy Martin all reported a significant decline in profits. Diageo, which was more exposed in Ireland and Greece at

the time they were saddled by the debt crisis, was the worst hit of all, indicating a strong negative impact on sales.

Luxury cosmetic and fragrance brands were hit by the recession, too. Estée Lauder and L'Oréal slid into the red, and undertook significant cost-cutting operations. The recession hit this segment in part because women tend to stock beauty products and perfumes. During times of recession, they usually fall back on the stock they have built over the years. However, some companies managed to stay profitable, including Sephora, Revlon, and Sally Beauty.

The crisis was affecting other brands, especially in the field of *arts de la table*. In 2009, Lalique, Daum, Baccarat, Cristalleries de Saint Louis, and many others suffered a great deal. On the other hand, 2009 was a very interesting period that tested the strengths and weaknesses of the sector. The conglomerates showed poor figures compared to the bright numbers posted year after year for the previous 10 years. Sales of brands such as Burberry, Armani, and Cartier—including the whole Richemont Group—suffered. Hermès, Louis Vuitton, and Prada were probably the most successful survivors; in fact they were winners in terms of announcing positive figures of sales.

The crisis was for real as far as the luxury world was concerned. The response of the luxury sector revealed to the analysts, researchers, investors, and other stakeholders that luxury was sensitive to the economic situation of the global world, just like every other sector. In fact, no one could pretend that luxury was invincible, and rich investors realized that the niche aspect of luxury was fading away. This was in fact the consequence of the evolution of the luxury world. Not only big and financially strong conglomerates with millions of customers faced the crisis—it was also faced by small family-owned players in the luxury business. They were all affected by the crisis and the stock market.

Strategic Response to Crisis

The strategic response to the crisis was not easy. It showed that the evolution of the luxury sector was still wide open. Transformations were taking place. Luxury could not be defined as it had been before. Brands

had to reposition themselves during the crisis, adopting starkly opposing strategies.

The response to the 2009 crisis was varied. A change in consumer behavior was observed during the recession, wherein consumers spent a lot more time comparing prices of various fashion brands. Thus, the conversion of a potential customer into an actual customer required more time and resources. Before, a consumer bought 10 products, but now he or she buys just one, and only after careful deliberation.

The broad strategies adopted by players during and postrecession involved two fundamental orientations: internal and external. Internal strategies, as the name suggests, were internal to the company and were those that were not visible to the consumers, whereas external strategies were those that were undertaken to gain the consumer's attention and buy-in. The internal strategies included cost-cutting, greater focus on the product quality, financial restructuring, and downsizing. Bernard Arnault described it thus: "a natural tendency of companies during a crisis such as the one we are in now is to cut costs, drop prices, and stop expanding, because it has the most immediate impact on numbers."[6]

The external strategies included expansion in terms of both product offering and geography, repositioning, upscaling of the brand to tap the richer among the super-rich, or downscaling to recruit a larger customer group.

In response to the crisis, as a knee-jerk reaction, some luxury brands tried hiring freezes, reducing the number and the size of the collections, rationalizing media spending, and reducing headcounts. It was felt that dropping prices and cutting costs were the last resorts. The press referred to it as cost containment. For example, Dolce & Gabbana slashed its prices by 10–20 percent. At the same time the company began a search for alternative low-cost stitching techniques and reduced spending on advertising (returning to low rates of 20 years before). Stella McCartney closed its boutique in Moscow just 18 months after it was opened. Richemont closed 62 stores, mainly in the United States, while Burberry absorbed heavy charges on its Spanish stores. In November 2009, Burberry unveiled a cost-cutting program, which resulted in the

[6]Vanessa Friedman, 2009.

closure of the Thomas Burberry collection. It hoped to generate infrastructure efficiencies by shutting down six stores and reducing headcount by more than 1,000 people. All this cost Burberry $6.7 million in the period, with the hope the company would generate savings of $77.8 million. In response to the slowdown of Asia, their key market, Burberry announced in September 2012 that it would freeze hiring, lower travel expenditures, cut marketing spending, and defer IT projects. Estée Lauder followed a four-pronged strategy with layoffs of about 2,000 employees, freezes in pay, discontinuations of non-profit-making brands, and cuts in discretionary capital expenditures of 25 percent.

Contrary to the cost containment approach, Bernard Arnault stated, "What we have learned in the many crises we have been through is that this (cutting costs) is a mistake, especially when it comes to luxury . . . . If you don't put your products on sale, consumers feel they are buying something that retains its value . . . . Even during tough times we can continue to invest and during the crises I went through in the past 20 years, we always gained in market share."[7]

Different companies tried a different set of strategies to reposition their brands. Christian Dior exited its logo and accessory product business as it pursued an upscaling drive, in the hopes that the super-rich would not be affected by the crisis. Coach, which happened to be in the heart of the subprime crisis in the United States, felt that "normal" buying behavior among consumers had experienced a shift and consumer spending levels would never return to what they had been precrisis. Thus, an internal change in the company itself was required. Coach explored lower price options for the consumer, providing them with a larger range of accessible products. Driven by a similar thought process, Swatch and Ralph Lauren also launched products at lower price points. To reduce costs, some brands took their manufacturing operations to low-cost regions of the world. Prada and Burberry shifted their manufacturing base to China for certain products. Louis Vuitton considered building a shoe factory in India.

Armani suffered a 41.4 percent drop in its net profits in 2008–2009. Dior experienced almost flat sales through the recession, and Burberry,

[7] Vanessa Friedman, 2009.

which opened stores in India, the Middle East, Macau, and China, posted a loss of $8.8 million in 2009 compared to a profit of $232.5 million in 2008. Some companies, on the other hand scaled down their operations. For instance, Dolce & Gabbana scaled back their operations in Japan. As an LVMH executive summarized, "Before the crisis, we were putting a lot of energy into beautiful stores, but now we care a bit less about expanding our network and even more about design and price."[8]

However, some companies decided not to compromise on such factors. One of the major winners from the crisis, Bottega Veneta, had a very different strategy: The company decided to not change its positioning at all. Bottega Veneta continued to manufacture its products in Italy and invested in its artisans to ensure that they continued to produce traditional, quality output. The idea was to ensure that their product was exclusive enough to merit the premium price they intended to demand. It held steady and stuck to what it was best at—finely crafted products with clean, classic lines. This ensured that the brand was two steps ahead of its panic-stricken competitors. IWC also practiced this philosophy. It utilized handmade craftsmanship, limited distribution, and impeccable service. Hermès manufactured its leather goods and silk products in France and Italy and did not resort to production in China. Not only did some companies try to deliver unmatched service quality, but they also standardized this service quality across continents. This ensured that the consumer walking into an outlet in New Delhi would not get a different experience from one walking into an outlet on Rodeo Drive or the Champs-Élysées. Ritz-Carlton and HFS were brands that worked on the parameter of service excellence.

Continuing with varied strategic response, some brands saw the crisis as an opportunity and expanded through (1) widening or spreading to new geographies, and/or (2) launching new products. Notable among those companies that expanded geographically (or widened its base) were Prada, Hermès, Bottega Veneta, and Christian Dior Couture.

Prada, in 2008–2009, undertook its most aggressive investment plan. It hoped to get out of the crisis with a very strong distribution network. Having seen earnings slide by 22 percent in 2008, the company saw

[8] *The Economist*, "LVMH in the Recession: The Substance of Style," 2009.

heavy increases in revenues and profits from 2009 onward. Hermès, like Prada, expanded during the crisis. Hermès opened stores in Manchester in England, Las Vegas, Japan, India, Wuxi in China, and Busan in South Korea during that period. Hermès was known for weathering the crisis rather gracefully.

During the recession some brands launched new and special products while simultaneously trimming their overall product lines. This resulted in fewer offerings and simultaneous price increases on both existing and new products, stimulating consumer demand and generating market interest, discontinuing low-margin products, and increasing prices in some product categories. Some companies ventured into new products and product lines (deepening), whereas others consolidated their brands under one umbrella. Burberry ventured into a new product line with a stand-alone children's store in Hong Kong, Bottega Veneta ventured into watches, and Versace launched a new fragrance, Gianni Versace Couture. Brioni reacted to the crisis by including more accessible items in its product range of suits such as T-shirts. Coach kept the prices of its regular lines stable, but introduced new lines, such as the Poppy handbags, to cater to a less affluent segment. Estée Lauder moved away from a strategy that fostered competition among various brands. It believed in following a more synergistic and coordinated policy of brand interdependence rather than competition. Its aim was probably to make the consumer feel that its brands were complementary in nature rather than supplementary. By maintaining or increasing prices for example, these brands resegmented their consumers and were more likely to pick up market share after the recession. Francois-Henri Pinault, CEO of Kering, was of the opinion that "There's a new perception of luxury, a more discrete sophisticated luxury where notions of heritage and craft play a big role."[9]

During this period many consumers had to cut back on their purchases, and many sensed that it was not appropriate to show off with obviously expensive products. It was something that only traditional, artisanal, and legitimate houses could uphold. Brands did not act at all but kept true to their values and their traditional offerings. These included Hermès, Harry Winston, IWC, Chanel, and Patek Philippe.

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[9]Dominique Ageorges, 2010.

Some brands explored new channels to deliver their products to the customer. Gucci and Ralph Lauren adopted the QR code. This was an image that shoppers could scan and download through their camera phone to obtain more information about the product or make purchases via their phone. Cartier adopted advertising through mobile phones. Companies like LVMH and Gucci also adopted online retail as an option for selling their products. This was quick to gain acceptance in Japan, where 20 percent of consumers make their purchases online.

Some brands diversified during the recession to strategic but complementary businesses or acquired greater control of their current businesses. From 2000 onwards, most if not all luxury brands, be it multibrand conglomerates or family houses, expanded horizontally into different traditional luxury categories. For example, Louis Vuitton expanded into fashion, high jewelry, and watches. Montblanc expanded into watches and jewelry. Chanel diversified into high jewelry. Salvatore Ferragamo expanded into fragrances and accessories. During the recession, Louis Vuitton, Bulgari, Armani, Missoni, and Trussardi diversified into a nontraditional luxury goods category with the opening of luxury hotels. Moreover, brands acquired greater control of their core businesses to integrate vertically, purchased key suppliers, and bought back licenses and franchises to increase efficiency, control their brand image, and generate superior margins.

Some companies tried to understand changing customer needs during the recession. For instance, Diageo noticed that people reduced their consumption of alcohol outside their homes. Thus it launched premixed cocktails such as Smirnoff Tuscan Lemonade for home consumption. Ritz-Carlton coined Mystique, its CRM system, to keep a closer tab on the consumers' pulse. Taking this flexibility a step ahead, some companies let the consumer guide the company, rather than the other way a round (which has been the norm in luxury branding). For instance, Nordstrom was lauded for its policy of refunding money to dissatisfied customers.

Conclusion

In conclusion, different brands adopted different strategies as a response to the crisis. None of the brands adopted a single universal strategy. They

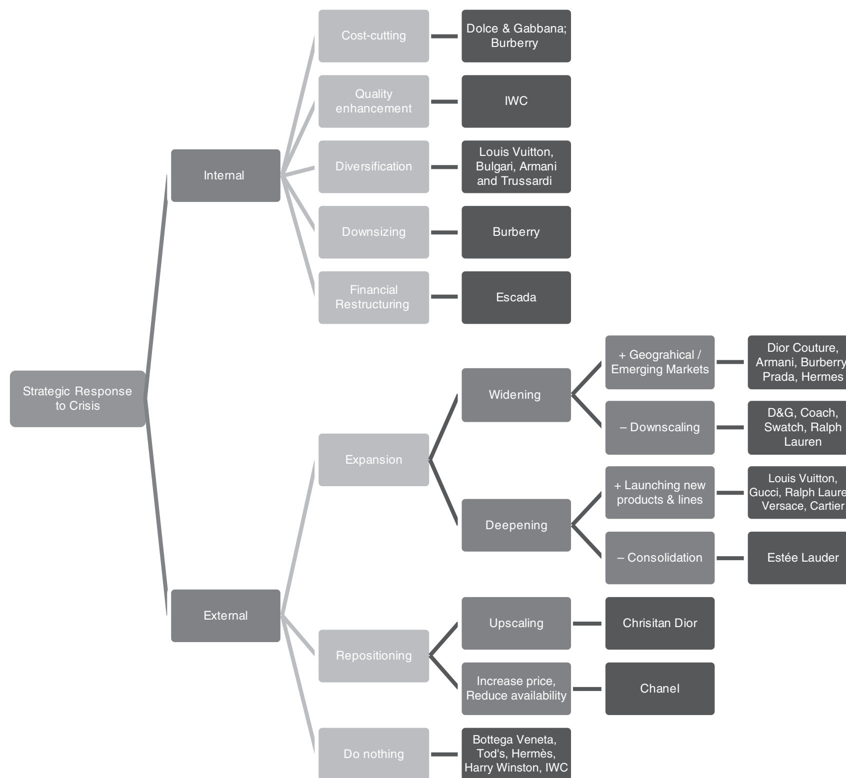

Figure 1.5 Luxury Brands and Their Crisis Management Strategies

remained creative in their responses. Some succeeded, some did not. As the industry rebounded, they adjusted. The bouquets of responses were meant to encompass different type of customers from different cultures and geographies. A global brand strategy was needed to convince several segments of clients—so different and interested by so many various luxury sectors. With crisis it was seen that luxury loses its definition, the market remained totally open, and goods varied from premium, super-premium, and ultimate luxury.

Formerly accessible to a few, the luxury industry democratized from 1985 onwards—three decades—with brand extensions such as perfumes and eyewear attracting more numerous (and younger) consumers. The future of luxury would therefore be built on the capacity of brands to

understand the scope of potential customers, fixing a strategy based on a specific language. There was no universal response, nor any universal language. Chanel speaks Chanel, Hermès speaks Hermès, and Gucci has its own vocabulary—the challenge is to keep the dream going, for everyone, after the crisis.

Figure 1.5 summarizes the different strategic responses of luxury brands to the global financial crisis.