

LUXURY MEMO SPECIAL REPORTS

## Off-price Luxury Memo special report

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*Off-price requires a balancing act for luxury brands. Image courtesy of Bicester Village*

By JOE MCCARTHY

Luxury brands develop their reputation by being exclusive, which makes selling products off-price inherently risky.

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But with the right strategic objectives in mind, cutting costs and becoming accessible can help brands reach more demographics and enter new markets, while maintaining the allure that allows them to stay attractive to high-end consumers. As the luxury market becomes more diversified, and as traditional gatekeepers get displaced by social media, off-price is becoming an increasingly attractive prospect for brands across industries.

"The big risk for luxury brand using off-price retailers is brand dilution and the loss of pricing power that comes with a decline in exclusivity," said Teresa Rivas, a financial market expert at [Barrons](#), New York.

"However, there are advantages, which is why so many companies do it, as lower price points allow companies to move merchandise that isn't selling well and potentially create a relationship with an aspirational customer that could spend more money on higher priced goods in the future," she said.

### Top 5 trends in luxury off-price

- Outlets

Outlet stores have always allowed luxury brands to sell excess inventory that would otherwise languish in warehouses, get donated or be destroyed. In recent years, luxury brands have been able to take back control from brand-diluting resellers through investments in outlets.

- Diffusion lines

Rather than selling previously exclusive items at reduced prices, potentially diluting brand value, many companies have attracted aspirational customers at lower price points by creating or buying diffusion lines. If poorly managed, these subsidiaries can end up cannibalizing sales from the core business, but effective oversight can help to build long-term equity.

- Ecommerce incentives

Off-price ecommerce incentives allow luxury brands to reach targeted audiences, experiment with product

offerings and get customers used to shopping online.

- Partnerships

Brands reluctant to go all-in on diffusion lines can experiment with mass-market partnerships. In recent years, as the preferences of millennials take over the luxury market, these partnerships have come to be seen as a critical marketing ploy.

- Special events

Luxury brands can use special events to experiment with off-price promotions to gauge customer reactions, move products and draw in new customers. Too many of these events, however, can run the risk of degrading brand value over time.

#### Outlet stores

Luxury brands have always had a rocky relationship with off-price merchandise. To brand loyalists, off-price can seem like a betrayal of brand values, which can result in declining revenue over time.



*Las Vegas North Outlets. Image credit: Simon*

Many brands have handled the delicate balancing act of going off-price with outlet stores that seem distinct from yet are still ultimately controlled by the brand in question.

Outlet stores help brands reach more demographics, enter new markets and control the overflow of products. However, a badly managed outlet network can cannibalize flagship sales and undermine a brand's long-term viability ([see story](#)).

Luxury department stores, in particular, have relied on outlets as a sort of release valve for overstock. Since department stores lack the prestige of the luxury brands that they carry, they are often forced to attract customers in ways that involve cutting costs.

Additionally, outlet stores have come to be seen as a major growth engine for department stores that have suffered from a lack of foot traffic to bricks-and-mortar locations. Major players in this field such as Nordstrom, Saks Fifth Avenue and Bloomingdale's have all invested heavily in their outlet programs ([see story](#)).



*Saks Off 5th. Image courtesy of Saks Off 5th*

Nordstrom, for example, sees its off-price subsidiary as serving the same customer base as its main location. The shopper who stops by the flagship store in the afternoon may check out the discount location afterwards to pick up some finishing touches to their wardrobe.

The brand is able to stagger product releases, selling only seasons-old collections at Nordstrom Rack, to keep the two companies fully distinct.

Off-price department stores that specialize in excess luxury goods have even emerged in recent years. For instance, MadaLuxe Group partners with brands such as Ferragamo and Versace to sell overstock items online, in outlet locations and in boutique stores in key luxury destinations ([see story](#)).

Outlet stores also help luxury brands fend off the rise of the resale market, which is projected to grow to \$33 billion in value by 2021. The resale market, which is driven by millennials, the sharing economy and a broad lifestyle trend toward decluttering, has the potential to siphon significant revenue from the luxury market ([see story](#)).



*MadaLuxe Vault store in Los Angeles. Image credit: MadaLuxe*

With outlet stores, luxury brands can match the price points of the resale marketplace, while differentiating through better curation and connection to the core brand's prestige.

Managing outlet stores can be tricky, but there are a few best practices that have emerged in recent years. Brands should have combined loyalty programs between outlet and core stores to keep a unified customer base, avoid product overlap and invest in robust ecommerce offers ([see story](#))

"It doesn't look like off-price will be going anywhere soon," Ms. Rivas said. "It was a bright spot for otherwise struggling retailers like Nordstrom in recent years, and customer seem continually focused on value, despite low unemployment and high consumer confidence, so it seems like a niche of retail that can keep growing."

#### Diffusion brands

While department stores generally go the route of outlet stores, individual luxury brands generally develop diffusion brands that promise comparable quality at lower price points in a bid to reach more customers and grow the parent company's overall bottom line.



*Image from Armani's "Stop and See" campaign. Image credit: Armani*

Diffusion lines generally focus on accessories and items that would normally warrant lower price points. In this way, luxury brands allow aspirational consumers to get a taste of the brand's values, while avoiding out-right cannibalization of the core business.

The affordable accessories business has boomed in recent years, and has created a boom in diffusion lines from luxury brands looking to tap into some of this revenue ([see story](#)).

However, this gold rush has had its drawbacks.

"Luxury is reinforced by high price," said Chris Ramey, president of [Affluent Insights](#), Miami. "The risk with cutting price is cutting the value of your brand. In luxury, off-price is always off-brand."

Fashion brands such as Giorgio Armani, Marc Jacobs and Michael Kors have all scaled back their diffusion lines in recent years because of market overreach. Marc Jacobs, for instance, bundled its Marc by Marc Jacobs line into its core business to create a more unified customer base ([see story](#)).

"Luxury brands must manage the actions of their department stores and specialty retailers," Mr. Ramey said. "There's a natural friction between retailers with too much inventory and brand managers who understand the damage that markdowns create."

In addition to diffusion lines, brands have also increasingly turned to licensing deals, an option that holds far more risk because it gives brands less control over the final product ([see story](#)). For example, British fashion house Burberry has had to cancel licensing deals in the past because of poor execution ([see story](#)).



*Rendering of Michael Kors' future SoHo store. Image credit: Michael Kors*

Luxury hotel brands also invest in diffusion properties to boost market share, counter the rise of the sharing economy, and enhance loyalty programs. The growth of Airbnb's luxury wing in recent years has sparked a reckoning across the industry that has forced hotel brands to diversify travel options ([see story](#)).

Oftentimes, this has meant expanding lower-end portfolios and focusing on developing compelling experiences at high-end properties.

Marriott International has even competed directly on Airbnb's turf by investing in a home rental business ([see story](#)).



*Home rentals are becoming extremely popular. Image credit: Primo Destinations*

"Luxury is a business model with specific pillars," Mr. Ramey said. "Airbnb is not a luxury purveyor even though they

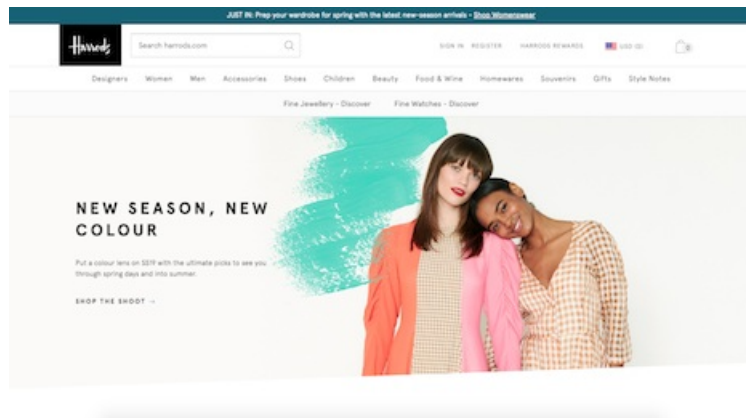
may rent some luxury homes to the affluent.

"Lowering the room price of a luxury property is not the appropriate response to Airbnb," he added. "Rather, it is Homes & Villas by Marriott International, a brand that can eventually dwarf Airbnb."

## Ecommerce incentives

Off-price is often best suited for ecommerce because sales can be organized and streamlined in ways that just cannot happen in bricks-and-mortar locations.

Brands can develop online flash sales with very short time windows that would be inconceivable in physical locations in an effort to drive revenue and gamify the process of getting rid of excess products.



### *Harrods' ecommerce site*

Flash sales can also allow brands to gather data and customer insights. By targeting select demographics with flash sales, organizing different sales on different social media platforms and changing the time frame for sales, brands can learn how to best structure future sales.

The holiday season is a critical time for brands looking to meet annual revenue targets, and sales often help them over the line. At the same time, brands want to avoid diluting their image with rampant price cutting during the most trafficked time of the year.

Ecommerce sales can help brands avoid this pitfall by setting the right limits around sales. Department stores managed to boost ecommerce sales 20 percent compared to the year before in this way ([see story](#)).

Flash sales on social media platforms can help brands build followings and test out the functionality.

Ecommerce incentives also help to build loyalty, drive repeat sales and improve the effectiveness of email programs.



*Longchamp Father's Day 2017 email*

While the vast majority of affluent customers say that they prefer to shop during sales, luxury brands have to be realistic about their ability to withstand the withering effects of going off-price ([see story](#)).

Ecommerce incentives offer one way to effectively control the process and put the brakes on brand dilution.

#### Partnerships

Brands wary of diffusion lines tend to test the off-price waters with partnerships with mass retailers, which also happen to be an ideal vehicle for reaching new customers and testing out new product lines.

Hotel brands, in particular have embraced partnerships in recent years as a way to experiment with new company directions. Oftentimes these partnerships are bundled and sold as package deals to loyal guests.

The Mandarin Oriental regularly partners with famous chefs in property locations for pop-up events that sometimes lead to full-blown restaurants ([see story](#)).



*Le Petit Chef at Mandarin Oriental, Marrakech. Image courtesy of Mandarin Oriental*

Hyatt Hotels recently partnered with the Small Luxury Hotels of the World to reach more affluent travelers through the platform's loyalty platform ([see story](#)).

Waldorf Astoria, meanwhile, brought the British toy company Hanley's to three of its China properties to offer family unique child-centric experiences ([see story](#)).

Fashion brands regularly leverage partnerships to reach aspirational consumers. Fast-fashion players allow brands to both become more accessible and deliver products with better delivery times ([see story](#)).

H&M has become a favorite partner for a range of luxury fashion houses because its customer base skews young.

Affluent millennial consumers tend to have less affinity for the traditional markers of luxury and are happy to mix high-fashion with low-fashion. As a result, partnering with brands of different price points, while counterintuitive, can help to build long-term brand equity ([see story](#)).



*Campaign ad for Balmain's partnership with H&M*

For example, Moschino partnered with H&M for a temporary collection that was debuted on Instagram for the music festival Coachella ([see story](#)).

Few brands have embraced partnerships more than the Italian fashion house Missoni, which has most recently partnered with the shoe brand Adidas for a collection of athletic wear ([see story](#)). Missoni Home also partnered with the mass market department store Target for a hugely popular capsule collection ([see story](#)).



*Missoni Home aligned with Target. Image credit: Missoni Home*

Some brands have teamed up with the ecommerce giant Amazon, despite concerns about brand dilution, to reach broader customer bases ([see story](#)).

"Framing provides cover," Mr. Ramey. "It may be bundled or a quid pro quo. Perhaps a special event, limited release, special gift or very private opportunity."

### Special events

Whether they are held in-store or as part of a branded experience, special events can give brands the appropriate messaging framework for going off-price.

Since, by their nature, special events are held infrequently throughout the year, customers expect offers that are out-of-the-ordinary, and for luxury brands that could mean hosting a sale.

A survey of industry insiders by Wealth-X found that 72 percent of executives view events as the marketing initiative with the highest return on investment, and the average luxury brand holds between one and four special events each year ([see story](#)).

Luxury brands generally go one of two ways when crafting special events. Either they are exclusively designed for loyal customers to show appreciation, or they are open to the public as a way to draw in new customers ([see story](#)).

Automotive brands such as Lexus regularly host seasonal promotional events, rife with exclusive experiences, to move products off the assembly line and into driveways ([see story](#)). Audi livestreamed fan stories at an event

designed to draw attention to its A3 car ([see story](#)).

Department stores also regularly host events to drive foot traffic.

Saks Fifth Avenue staged a circus to draw in customers and highlight certain product lines ([see story](#)), while Harrods has tapped British Vogue to curate fashion events ([see story](#)).

Hospitality brands, meanwhile, craft special events to mesh with their guests' calendars. During school vacations, hotels offer exclusive family-themed trips ([see story](#)), while peak conference season often yield business-oriented packages ([see story](#)).

As always, brands have to be careful about not pushing sales too hard during special events, and should emphasize the traits that warrant exclusive price points to begin with.

"Luxury brands are superlative," Mr. Ramey said. "There is only one Mandarin Oriental, Ritz-Carlton, Four Seasons, etc. Each has its own unique experience."

#### 5 Best practices for luxury off-price

- Chris Ramey, president of Affluent Insights, Miami:
  - "Luxury is brand. Brand creates value. A good brand negates the need to go off-price."
  - "Best practices for going off-price include outlet centers as far as possible from major metropolitan markets. Be found alongside other luxury brands that shouldn't be discounting either."
  - "Leverage a bridge brand. Find ways to justify the markdown and separate it from your brand."
  - "Best practices for flagship stores includes ensuring sales are for very short periods of time, as well as private and evening sales."
  - "Personal shoppers should be tuned-in to inventory issues and do what is right."
  - "Partnering with philanthropic causes or museums for events provides some cover for markdowns."