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MARKETING

Cyclicality, coronavirus and luxury consumers

March 10, 2020

Many would argue that French fashion and leather goods giant Hermes is structured and positioned for long-term survival and growth. Seen here, the new Rouge Hermes line of lipsticks, which is set to become another best-seller. Image credit: Hermes

By Ashok Som

A moot point in the luxury business is whether it follows a business cycle or not.

Those who are for the motion will argue that luxury is today a thoroughly global business.

Though luxury goods and services are made and distributed primarily from France, Italy, Switzerland and the United Kingdom, its consumers are global. Thus, any natural calamity or disaster would have a direct implication on the business.

Those against the motion will argue that luxury is not like any other business. It is dependent on the enhanced disposal income.

In current world, wealthy consumers with growing disposable income know how to protect their wealth. Thus, the proposition by economists studying rising income inequality that the rich get richer while the poor get poorer in most nations.

These high-net-worth individuals would hence posit that, whatever the cycle, they would continue to consume. Hence, luxury businesses will constantly deliver results, whatever the cycle.

Following the above argument, the most important driver for luxury brands to succeed was, thus, dependent on the disposable income of its clientele, which translated to consumer buying power.

The disposable income of high-net-worth individuals had increased substantially during the preceding 10 years.

As mid- to high-income society became relatively more affluent, consumers with disposable income were "created" through strategic decisions of brand building that fuelled the desire and subsequent demand for products beyond the individual's basic needs.

These strategic decisions were planned and are at the very core of luxury brands. The decisions were executed. Seamless execution was the hallmark of strategy implementation.

But what if, when all is going well, certain events are not under our control?

Crises over the past two decades
For example, 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.

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 continued to have effects such as the Cyprus bailout and political turmoil in Russia and Italy. During 20092013, this industry felt the impact of the crises.

The lessons from the financial 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 due to the belief in *non-cyclicality, product, geographic and sectoral diversification, category segregation and demand frustration*.

The general opinion was rebound is imminent and that the losses would soon be overshadowed by the perennial story of growth and profitability.

In 2020, the situation has repeated itself with outbreak of the coronavirus.

Health is wealth
The rapid spread of the respiratory illness, COVID-19 or, novel coronavirus has resulted in thousands of deaths, travel bans, store closures and facemask shortages. Once more, the luxury business has to recalibrate.

The outbreak, which originated in the Chinese city of Wuhan in Hubei province, has so far killed more than 3,000 people with 100,000-plus infected worldwide, mostly in China.

The crisis is for real, as far as the luxury world is concerned. The response of the luxury sector revealed to analysts, researchers, investors and other stakeholders is that luxury is also sensitive to the economic situation of the global order, just like every other sector.

In fact, it is almost nave to pretend that luxury was invincible. This is, in fact, the consequence of the evolution of the luxury world.

Not only big and financially strong conglomerates with millions of customers are facing the crisis, but also small, family-owned players. They are all affected by this crisis and the stock market.

For example, on Feb. 25, the S&P 500 just wiped out about $1.737 trillion of its value during its two-day market sell-off, according to S&P Dow Jones Indices.

None of us were prepared.

Even all the strategic planning experts could not have predicted these events and the extent of its effect on business.

Historically, the luxury business has been resilient. The strength of the brands and the rising disposable income in emerging and frontier markets makes it resilient.

As the consumers' sentiment rebounded and luxury became the industry to look forward to especially in the CAC40, which saw a 20 percent rise in the last five years primarily due to the luxury stocks of LVMH, L'Oreal, Kering and Herms.

The crisis comes as the luxury sector was trading near all-time highs of about 26 times forward price-to-earnings, after years of strong growth driven in large part by Chinese consumers.

One month or one quarter is a localized event, but the effect over a year can be an entirely different issue.

To start with, travel retail is heavily affected. The supply chain has been severely affected. Business at stores is affected. Stores need to be closed. Consumers have to stay indoors.

The strategic response to the crisis will not be easy. It just showed that the evolution of the luxury sector is still wide open.

Applying lessons from 2009 and the Great Recession
Extrapolating learnings from the 2009 crisis, the response at that time 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 on the Internet.

Thus, the conversion of a potential customer into an actual customer required more time and resources.

Before, a consumer bought 10 products, but then she bought just one, and only after careful deliberation.

The broad strategies adopted by players during the crisis involved two fundamental orientations: internal and external.

Internal strategies were internal to the company and not visible to the consumers. Whereas external strategies were those that were undertaken to gain the consumer attention and buy-in.

The internal strategies included cost-cutting, relocating supply chain and inventory, greater focus on product quality, financial restructuring, and downsizing.

Managers described it as 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.

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

In response to the 2009 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.

Next steps
What can luxury brands do in this scenario? What would be their strategic response to this crisis?

- Renew and re-engage in relationships
- Data mine to establish personal connect with all stakeholders including family members, customers, employees and suppliers
- Identify and keep the interest of the loyal consumers
- Harness and engage with the power of ecommerce by moving products and preferences
- Customized attention to all loyal clients with rewards for loyalty
- Encourage participation and interaction on social media over hand held devices and mobile aps
- Wait, watch and stay in touch

TAKE WHAT this salesperson at Paris' Place Vendome had to say:

"*This year the Fashion shows will be different. China is absent. Many empty seats. At the last show we had a pink croc jacket. We never thought it would sell. It was for the show. At the end of the show from nowhere a Chinese client came up to the buying area and ordered the coat for 130,000 Euros. We are going to miss them this time around.*"

Only time will tell about the unfolding events of cyclicality, bracing COVID-19, and changing consumer tastes and preferences.

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