

HIGH FASHION IN A RECESSION

THE EVOLUTION OF THE LUXURY HANDBAG

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THE LUXURY GOODS MARKET was traditionally believed to be recession proof because the majority of its sales were generated by consumers whose disposable income was only marginally impacted by an economic downturn. While this analysis may have been true in the past, today's market is vastly different. The resilience of the market in economic downturns is weakened when an increasing percentage of luxury goods companies migrate from exclusivity and prestige towards the mass market, thereby vastly expanding their customer bases and cash flow. Now, most luxury companies not only cater to the wants and needs of the middle and upper-middle class, but depend on them. This article will use the luxury handbag market as a case study outlining both the market and effect of the global economic recession.

LUXURY GOODS MARKET

In 2008 the size of the luxury market totaled US\$230 Bn. Since the 1980s, the luxury consumer base has become broader and more complex, forcing luxury companies to reconsider their market planning strategies. The focus on exclusivity of the 1980s gave way to brand proliferation and increased availability (due in part to a lower average ticket price) in the 1990s, which then transitioned into diversification of product offerings in the 2000s. A customer base with constantly evolving aspirations has gradually pushed luxury goods companies from a designer driven to a customer-focused approach.

The growth in the handbag market over the past five years was fueled in part by the "It Bag" craze among the growing segment of



affluent women. This trend was supported by rapid style innovations by companies such as Mulberry, Bottega Veneta, and Burberry, who saw strong growth in their premium handbag and accessories sales. In 2006, 25% of Louis Vuitton's sales came from new styles. However, in 2007 the growth for premium handbags slowed down to 4.8% a year, as consumers became less willing to spend thousands on the latest trend.

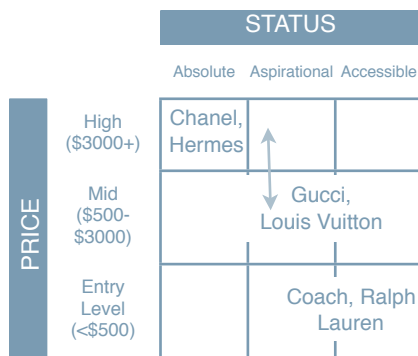
LUXURY HANDBAG SEGMENTATION

The premium handbag market can be divided into three categories:

1. **Absolute:** This segment's brands appeal to consumers for whom money is not a consideration and who appreciate brand history and reputation.
2. **Aspirational:** Brands competing in this segment are still viewed as prestigious, but appeal to customers with slightly lower income. They often include broader and faster-changing product lines.
3. **Accessible:** Brands in this part of the market appeal to consumers in middle and upper-middle class, who strive for luxury goods as symbols of differentiation and status, but have budget restrictions. They are also the most susceptible to the purchase of counterfeit items.

According to Luca Solca of Bernstein Research, 60% of the luxury market is now based on demand from aspirational customers rather than from the wealthy elite. These customers can shop in the first two price segments, but can rarely afford the \$3,000+ price tag. Brands in this segment still portray elitism and exclusivity, but have a slightly more affordable image than those in the absolute segment.

High Fashion in a Recession



IMPACT OF THE RECESSION

The current financial crisis has significantly impacted luxury revenues and profits. In 2008 the market stagnated, hitting its second lowest growth performance in over 10 years. As stated by Stephan Sadove, CEO of Saks Fifth Avenue, “shoppers are in frozen mode...clearly, our customers don’t feel wealthy. They are not in the mood to shop.”

As GDP growth slowed worldwide and the level of debt increased, luxury consumers were affected as their cash inflows decreased and balance sheets shrunk. Decreased cash flow was driven by a shortage of disposable income due to rising unemployment, tightening credit and increased debt servicing cost. The reduced value of balance sheet assets was caused by a drop in the value home equity, shares, and retirement plans. Decreased consumer cash flow is a classic short-term recessionary impact, while the decrease in consumer “balance sheet” assets affects confidence and financial capacity in the medium-term. Consumers of aspirational brands were severely impacted by the decrease in personal cash flow and have significantly modified their purchasing behaviors. A healthy economy broadens this segment of the luxury goods market by increasing average disposable income to a level that permits occasional luxury spending. Not only have aspirational segment purchases decreased, but many companies mistakenly

overestimated the true size of their absolute market.

Customers in the absolute segment are less impacted by the recession. In recent years, stock options, hedge funds and Wall Street have created many new fortunes that are not dramatically impacted by economic downturns. This is reflected in the relatively strong performance of absolute brands such as Hermes and Chanel. In general, this segment still has the disposable income to purchase luxury goods though some consumers may choose to modify purchase choices and volumes.

THE LUXURY HANDBAG MARKET

In the short-term, consumers scaling back their non-entry level handbag purchases. In the long-term, changing consumer aspirations and buying patterns in the handbag market could have a lasting effect. Consumers are increasingly reluctant to pay for handbags at full price and are waiting for sales. Since mid-September 2008, promotional activity has escalated across the entire sector and consumers are actively looking for good value purchases. Ostentatious items are substantially less popular than more discrete, classical or durable items. Industry experts suggest that “the era of conspicuous consumption, at least for the foreseeable future, has come to close.” Handbags are increasingly viewed as an investment due to the high frequency of repeated use. Service and experience are now paramount in consumers’ buying behaviours. 80% of luxury consumers surveyed by American Express agreed that an important part of their enjoyment of a luxury experience was how well the service personnel treated them and the extra service they provided.

STRATEGY IN A REDEFINED MARKET

Traditionally, all aspects of a luxury handbag were decided by a company’s creative talent – its designers. Product development was based solely on their

vision and interpretation of the main trends of the season; trends they either set or followed depending on the market position and reputation of their company. Luxury handbag strategy was an art. With changing consumer preferences and tightening consumer budgets, these companies can no longer dictate to their clients what they should want to pay a premium price for. An “art+science” approach to market planning must be adopted to successfully deal with recessionary pressures and the lasting impacts. The science part of this equation means a tighter focus on market planning to ensure that what the company offers is what its particular segment wants. This means a change of approach to product development, customer service, and cash flow management. A more business-focused approach will allow luxury handbag companies to turn this recession into an opportunity for growth.

PRODUCT DEVELOPMENT

Luxury handbag companies must change their approach to product development to introduce products that better fit the market they are targeting. This can be accomplished by seeking out consumer insights on design, colour, and functionality and incorporating them into new collections. Though customers do not always know what they want when it comes to a designer product, they are often certain about what they do not want. Luxury handbag companies need to develop a more systematic, disciplined and formal approach to capturing consumer behavior, thereby embedding the voice of the consumer into creative and merchandizing processes. During the recession, these companies still need to take risks with their designs, but these risks need to be creative and calculated.

With focus shifting away from ostentatious consumption back to the intrinsic value of a product, handbag companies must manufacture and position their new offerings as “classic”. As suggested by F.H. Pinault, CEO of PPR, “people want to return to genuine values like timelessness.” Handbags must be seen

as durable and high-quality, as opposed to the latest “It” bag; investments, rather than discretionary purchases. For example, in June 2005 Valerie Hermann, CEO of the then struggling YSL, introduced a new handbag known as the “Muse.” By the end of the summer, it had achieved widespread popularity and was deemed a bestseller. This handbag, an oversized leather carryall, was versatile and timeless, thereby appealing to a broad range of

YSL MUSE



BOGETTA VENETA BALL



CHANEL 2.55



customers. It is still popular today and has been instrumental to the newfound profitability of YSL.

The “Muse” bag and other successful recent product offerings share common qualities: they are discrete, practical and classic. They lack product features such as

oversized labels and flashy adornments, further illustrating the fact that luxury consumers have an increasing interest in functionality. Extravagance should give way to esthetically pleasing practical, understated design. This will be appreciated by customers in all segments.

Balancing high fashion items with a more commercial offering will help companies generate cash flow by expanding their customer bases, if the previously proposed principals of functionality and timelessness are adhered to. It provides an entry point for younger customers who are likely to transition up market as they accumulate wealth. An entry level product would not constitute a full repositioning in the market, but a small diversification initiative. A good example of such diversification is YSL’s “Edition 24,” a permanent, season-less and sharply priced collection of essentials. This collection’s entry-level handbags were priced at €1000, broadening YSL’s customer base and appealing specifically to fashionable business women. As stated by lead designer, Stephano Pilati, “it’s not a second line, [but a way to] address fashion in a more accessible way... And it’s not necessarily linked to the direction of the season.” The collection has since contributed positively to cash flow through increased sales volumes. It is instrumental that lower priced offerings differ in name, design and materials so it is not confused with core product offerings. For example, Marc Jacobs produces his namesake collection and a lower priced collection called “Marc by Marc”.

Entry level product offerings in applicable segments aid brand development, unlike promotional discounts. Consumers are less likely to invest in a luxury handbag if there is a chance that its status will be eroded by end-of-season sales. Louis Vuitton, a brand that has performed well despite the recession, understands this risk and manages pricing accordingly. The company “never discounts, never has a sale” because it views both strategies as “image-killing, brand-killing.” Louis Vuitton is able to adhere to this policy because of their classic product

offering, excellent customer service, and exceptional production planning, which allows it to efficiently manage inventory levels.

CUSTOMER SERVICE

Another important aspect of luxury companies’ short-term focus should be customer service. Sales staff needs to be trained to be friendlier and more approachable, able to identify consumers’ intrinsic desires and pitch them the appropriate product out of the company’s line. Luxury handbag companies should also attempt to shorten their supply chains through industrialized logistics in order to reduce the time it takes for a product to get to market. This will lead to better customer satisfaction through shorter delivery times, as well as enhance the business’ capability to refresh and reduce inventory.

CONCLUSION

The recession has increased the power consumers have over luxury goods companies. Given this new reality, corporations must better tailor their product offering and service to the desires of their chosen segment. They need to adopt a more business-focused “art+science” approach to developing their collections and selling them to customers.

More than ever, companies need to pay attention to their cash flow management and focus on reducing unnecessary expenses, while looking for additional sources of revenue. Throughout the process, innovative product development and advertising must be maintained. The success of these strategic initiatives is dependent on one key element: companies must attract not only star designers, but star managers. The long-term success of luxury handbag companies follows a cyclical pattern: art creates the need for science, and science enables the future of art.