WALTER SCOTT

BNY MELLON | INVESTMENT MANAGEMENT

FOR USE BY INSTITUTIONAL INVESTORS ONLY. NOT FOR USE WITH THE GENERAL PUBLIC.

LUXURY WE CAN'T AFFORD?

EXTRACT FROM THE JOURNAL, ISSUE 11. FIRST PUBLISHED NOVEMBER 2020.

When a global crisis hits, what does it mean for the likes of Chanel, Ferrari and Louis Vuitton? We find out how the luxury goods sector is faring as the Covid-19 pandemic turns the world upside down.

"Luxury is a necessity that begins where necessity ends." As Covid-19 closes city centres, slows production to a crawl and deals a body blow to the travel industry, do Coco Chanel's words still hold true? Just how much of a necessity is luxury to its traditional consumers when a recession of historic magnitude looms on the horizon?

The Financial Times reports that HSBC has forecast that luxury goods sales will fall by 17% this year, Bain & Co has predicted a decline of between 20% and 35%, and analysts expect it to take until 2022 or 2023 for sales to return to last year's €281 billion.[1] These statistics are grisly, but they conceal a more nuanced picture.

THE REAL DEAL

Luxury is aspirational, so the word is overused by many companies. Luxury-goods consumers and investors need to be alert to imitators. Alistair Green, CMO of British haute-couture house Ralph & Russo, says that there are four ways to identify a luxury brand: craftsmanship, heritage, aspiration and symbolism.

"For a luxury brand and a luxury consumer, craftsmanship is part rational, part emotional," he says. "It's the justification for paying the huge price tag." Heritage, meanwhile, is a particularly powerful selling point for founder-owned brands such as Chanel and Dior, and it tends to go hand in hand with craftsmanship.

"A real heritage brand will be handcrafted, because mechanisation didn't really exist when it was founded," says Green. "Dior and Chanel have in-house ateliers. There's no real reason for them to have a button or feather atelier – at great cost – but it keeps them at the top of the pile because other couture brands don't have that heritage."

Brands qualify for Green's third criterion, aspiration, through exclusivity. High prices and limited stock guarantee that not even the super-rich can secure, for example, a Hermès Birkin bag. It also means careful product placements with online influencers and celebrities. "That's something that's part of the challenge now," says Green. "Because what made a brand aspirational to a luxury consumer 20 years ago is not the same as it is today."

"An old craftsmanship, aspirational brand can very easily find itself irrelevant to a younger, newer luxury consumer, and that will start to affect the bottom line. The best luxury brands do a very good job of maintaining relevance."

Alistair Green, CMO, Ralph and Russo

Finally, symbols, which are even more important to luxury brands than to other brands. "A symbol is the status and the badge of the brand," says Green. "If you're trying to build aspiration and you have a story that represents craftsmanship and heritage, you need something to stand for all of those things." Symbols are also a commercial necessity. They allow luxury brands to charge premium prices for goods such as sunglasses that sit at the more accessible end of the market and represent a sizeable revenue stream.

Today, there is another hallmark of luxury to add to Green's craftsmanship, heritage, aspiration and symbolism: relevance and the 'cool factor'. "Essentially, that means being relevant to what's going on in today's culture, and today's luxury consumer's mind and life and behaviour," says Green. "An old craftsmanship, aspirational brand can very easily find itself irrelevant to a younger, newer luxury consumer, and that will start to affect the bottom line. The best luxury brands do a very good job of maintaining relevance."
To this list of luxury criteria, Lindsay Scott, Investment Manager at Walter Scott, would add one more: a sense of belonging to something special. "The CEO of Louis Vuitton describes it as a club," she says. "Once you join, you want to stay in the club forever. If you're carrying the brown bag from Vuitton or have the H of Hermès on your bracelet, it speaks to your personality and what you want people to think of you."

A CRISIS LIKE NO OTHER

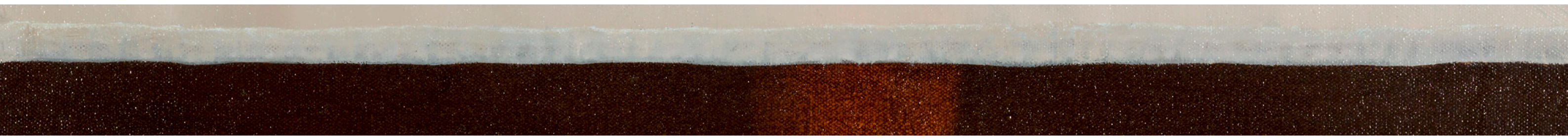
The brands that do tick all of these boxes have proved to be remarkably resilient in the face of previous economic downturns. According to Bain & Co, the global financial crisis slashed 9% off the size of the personal luxury goods market,[2] but heritage luxury brands weathered the storm; some – Louis Vuitton, Hermès – even increased their brand value.[3]

This time, it is different. "This crisis is different from any other I've experienced in the luxury sector in the past 20 years," says Claire Kent, luxury goods consultant and founder of Iffley Road, which produces high-quality men's running wear. "Previous crises had a short-term impact on travel and tourism. This seems more structural and probably long-lasting."

"Previous crises had a short-term impact on travel and tourism. This seems more structural and probably long-lasting."

Claire Kent, luxury goods consultant

The slump in Asian tourism, which is the source of much of the luxury goods sector's revenue, is one reason why recovery is likely to be tougher this time. The big flagship shops in European capitals welcome a large share of tourists through their doors, and with tourism down on last year



the stores are quiet – and will be for the foreseeable future. "I can't see Asian tourism returning to previous levels," says Kent. "Until a vaccine is found."

She believes that attitudes towards conspicuous consumption have also changed – certainly among Baby Boomers. "I feel it has fundamentally affected people's attitudes towards spending," she says. "And I think a lot of people would prefer not to flash their wealth.

"As a sector, we do move in cycles," she adds. "It could be that that [attitudinal shift] remains the case for three or four years before we move into a different cycle."

Linked to these sensitivities are uncertainties surrounding the future – and how they affect people differently. Concerns over job security will reduce spending on discretionary items, and this will divide consumers of high-end luxury for whom redundancy is not an issue and those for whom discretionary spend becomes something to be careful about.

STRUCTURAL CHANGE DRIVES INNOVATION

The possibility of longer-term changes to the market is a cue for luxury brands to assess their positions. For the past decade, they have all followed a similar strategy: opening more – and larger – stores catering for the Asian market, and withdrawing from department stores. Now, the crisis is forcing management to assess the size of their store networks, including flagship stores, and their store expansion plans. It is also focusing their attention on e-commerce and innovations that could improve the user experience. This is nothing revolutionary, of course – it is accelerating an existing trend. "I think Covid-19 has really just been a catalyst for what would have happened anyway over a three-year period," says Kent.

The luxury giants ought to be comfortable with taking an innovative approach. Innovation intertwines with relevance and the ability to appeal to younger generations, and luxury companies have a good track record here. One example of their innovative approach is the way that some are partnering with unexpected brands.

"Supreme is a street label brand, but Louis Vuitton has partnered with it because it's probably one of the coolest brands on the planet right now," says Alistair Green. "It doesn't really come from the luxury world, but because of its cool factor it's still incredibly expensive and covetable – and is worn by a lot of the right celebrities and influencers."

> *"If there is a vaccine, will things return to normal – or has there been more of a structural shift?"*
>
> **Claire Kent, luxury goods consultant**

Lindsay Scott agrees that this kind of combination is what makes a successful partnership. "It makes the brand interesting to a younger cohort," she says. "While retaining that core mainstay of heritage."

Innovation is a key reason why some luxury companies have grown faster than others over the past decade. Not only are they exploring new partnerships, but they are also innovating their products and transforming the way they communicate with customers.

Green agrees that brands need to ensure they can stay up to date. "I'm surprised by how much potential luxury brands are still sitting on," he says. "There are also still parts of the luxury world that are almost inaccessible and closed. If they can open up more while still retaining exclusivity, and be willing to bring in new skills from outside, it can be a really potent combination."

WHAT LIES AHEAD

In normal times, innovating their strategies, thinking beyond bricks and mortar and recruiting young talent to the team would stand luxury brands in good stead. But these are not normal times. As the pandemic continues to cause turmoil, what else should be on CEOs' to-do lists?

"The footfall in European stores is down on last year, so cost control is paramount," says Kent. "They should also be taking a view on what happens next. If there is a vaccine, will things return to normal – or has there been more of a structural shift? Will Asian customers start consuming European luxury more locally, or buying it more online? All of those things will determine the investments they make in future stores.

"For smaller designer brands, the whole issue will be one of survival," she adds. "But most of the European luxury powerhouses are cash rich and well protected, and they will be able to manage any blow."

Luxury should continue to be a "necessity" – at least for high-net-worth customers – but Covid-19 is changing the way those customers buy it. This is a crisis like no other, but the brands that can keep up with these changes while holding on to their special craftsmanship, heritage, aspiration and symbolism look well-equipped to survive it.

---

[1] https://www.ft.com/content/149c4be8-9fd9-46ff-a161-86f3ef86a2d6

[2] https://www.voguebusiness.com/companies/luxury-recession-saks-bond-yield

[3] https://www.luxurysociety.com/en/articles/2013/02/why-some-luxury-brands-thrived-in-the-us-despite-the-recession

IMPORTANT INFORMATION

This article is provided for general information only and should not be construed as investment advice or a recommendation. This information does not represent and must not be construed as an offer or a solicitation of an offer to buy or sell securities, commodities and/or any other financial instruments or products. This document may not be used for the purpose of an offer or solicitation in any jurisdiction or in any circumstances in which such an offer or solicitation is unlawful or not authorised.

STOCK EXAMPLES

The information provided in this article relating to stock examples should not be considered a recommendation to buy or sell any particular security. Any examples discussed are given in the context of the theme being explored.