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WHAT'S NEXT FOR LUXURY BRANDS?

Why relevance, agility, and endurance will drive the recovery and resurgence of retail's luxury brands beyond the COVID-19 pandemic.

The luxury goods market is poised for its first annual contraction in 20 years. Global sales are expected to fall 20 to 30% in 2020, as businesses close stores, cancel fashion shows, and shut or repurpose factories.

With the world beginning to emerge from the COVID-19 healthcare crisis, luxury brands are facing challenges as a result of a significant global economic downturn. This will require new ways of engaging with consumers and force the recalibration of operating models. Many preexisting trends—particularly digital transformation—must be accelerated. And for an industry that was built family business by family business, but is now dominated by conglomerates, the scale and scope of change requires new approaches.

Despite those immediate prospects, the fundamental strengths of the luxury goods industry endure: powerful brands, creative leadership, devoted customers, and high margins. Demand will return, but the future of luxury will look very different.

Like other crises, this one will pass, and many luxury brands will rebound, subject to the effective positioning of a business for that eventual recovery. But now is the time to focus on critical areas that may be heavily disrupted, before looking to effect other necessary business transformations that might have been unmanageable in a better environment.

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EYES ON ASIA TO AID RECOVERY

It's tempting to suggest that the luxury market will be less affected by the crisis than other sectors and that the industry can quickly return to business as usual. The luxury market's customer base has seen its employment and disposable income affected less by the economic downturn. And if history is any guide, this market will also be the fastest to recover when economic growth returns.

In 2008 and 2009, luxury sales continued to grow despite the global financial crisis on the back of dramatic growth in Asia. Sales in that region have grown at over 8% a year since 2008, representing some 80% of revenue growth for the industry. Tourism by Chinese consumers during the same period has grown tenfold, with a large proportion of Chinese consumers' luxury goods purchases occurring while on vacation in order to take advantage of reimbursements of value-added tax. If there is a strong economic recovery in Asia—and in China in particular—then demand could snap back fast. However, the industry may not be able to rely on factors that have buoyed it in the past. Global economic output is likely to stall for some time, determined largely by whether there are second waves of infections and how soon a vaccine and effective treatments can be developed.

Given the depths of the contraction and the need for reopening on a gradual basis, recovery will likely be slow. The International Monetary Fund predicts a 3% drop in global economic output in 2020—with many economists predicting substantially more—and 3 to 5% growth in 2021. It will likely take two years before global economic output returns to precrisis levels.

Asia may again be a savior to luxury companies, but that too is unclear. In the first quarter of 2020, China reported its first economic contraction since the death of Chairman Mao in 1976. Initial reports out of China following the easing of lockdown restrictions suggest that demand is picking up. But will it be enough? And given the importance of tourist dollars to luxury sales, including duty-free shopping, ongoing travel restrictions will likely prove to be dampeners to recovery.

SECURITY OF SUPPLY IS KEY

Many suppliers—relied on heavily by the large fashion houses—may declare bankruptcy, and sources of key materials will take a long time to recover. According to reporting in the newspaper *Corriere della Sera*, half of the small factories that support the fashion industry in Italy—most of them employing fewer than 100 people—are in danger of collapse. And the disbursement of government loans and grants to those small businesses has in many countries become mired in bureaucracy, putting pressure on already-challenged luxury groups to step in with support.

The disruption of the fashion calendar has also unsettled certain established ways of engaging with luxury consumers. Many brands were already relying heavily on digital marketing, social media, and influencers as ways of reaching younger affluent consumers. For example, in 2018, Kering was already spending half of its annual advertising budget on digital media. And digital commerce is becoming an increasingly important channel for luxury goods—particularly in mainland China.

The pandemic has accelerated both of those trends, with many Chinese consumers turning to digital platforms like Tmall for luxury goods purchases. And the recent online fashion weeks in Paris and Milan demonstrated houses' ability to engage digitally with their consumers. However, a survey of consumers by Vogue Business in late 2019 and early 2020 showed that most consumers were unimpressed with companies' digital experiences, ranking digital marketing as one of the lowest metrics tracked.

Consumers have been affected by the pandemic in differing, and often deep, ways. Before the crisis, many companies were already reevaluating their environmental and social impacts. In its wake, the engagement of consumers around sustainability and purpose has become a more urgent task.

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ADDRESSING THE CHALLENGES OF SCALE

Even before the COVID-19 crisis, trends were driving change in this industry.

Luxury has always been big business, but the largest luxury groups have grown larger and more complex in recent years through a combination of rapid growth and consolidation. Exclusivity remains a central selling point for luxury brands, so there is inherently a limit on how large a brand can become before diminishing its own allure. The larger luxury groups have navigated that challenge by maintaining the independent identities of the brands that they have added to their portfolios while taking advantage of economies of scale for commercial real estate, marketing, and back-office functions.

Some brands continue to pursue independent strategies, of course. The largest of them, Chanel, reported over $12 billion in revenue in 2019, which demonstrates its scale in its own right.

Many such companies also have transformed their supply chains by acquiring their most important—and often beleaguered—suppliers so as to ensure their ability to continue producing their goods such as lace, embroidery, beads, and exotic skins. What had historically been a network of family-centric ecosystems is now a sophisticated supply chain network.

The ability to manage these kinds of operations requires skill sets different from those needed even 20 years ago, and the competitive landscape too is very different based on dominance by a few big players. Independent creative control and brand identity are crucial value drivers for those groups and taking full advantage of potential synergies is complex both operationally and culturally. Successful brands are reluctant to relinquish control to parent companies, but to achieve their full value potential, some functions such as human resources, real estate, and digital commerce need the scale that the parents can provide. Even in carefully guarded areas such as supplier relationships, significant synergies can be achieved by combining efforts.

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HOW TO MAINTAIN CONTROL IN AN EVER-CHANGING ENVIRONMENT

In today's uncertain times, luxury brands must focus on what they can control now—their supply chains, their channels, and their consumer communications—so that they can adapt as new conditions emerge. Focusing on three key characteristics can help luxury brand companies prepare for the future.

1. RELEVANCE | **2. AGILITY** | **3. ENDURANCE**

1. RELEVANCE

In a world that has become reset and perhaps revalued, the luxury market will have to carefully position itself. It must reengage consumers in a dialogue around luxury brands in a way that is relevant and authentic in a changed world. They must answer questions such as:

- Does the market need as many fashion weeks as before?
- Does it need as many collections?
- Does it need as many products?

Reductions in consumers' disposable income may push consumers to become more conscious of what they buy, focusing on quality over quantity. And environmental concerns may cause a rethink of flying halfway around the world for a 10-minute runway show.

Brands are experimenting with online presentations and interactions with designers. In addition, digitization in the design process can reduce waste, minimize travel, and facilitate the use of data analytics to incorporate customer and market feedback into product design. And enhancement of consumers' overall experience and engagement with brands can only benefit.

BAKE SUSTAINABILITY INTO BUSINESS STRATEGY

The rapid rise of resale and rental as well as a focus on sustainability will be central to a successful brand's DNA, given luxury businesses' increasingly broad network of stakeholders and associated societal impact. Richemont, for example, purchased a resale and rental business in order to take control of its products on the secondary market and enhance its omnichannel strategy. The big brands are very good when it comes to corporate social responsibility, but they're facing more and more challenges around carbon footprint and environmental impact. That will have a major impact on products, cycle frequencies, and core brand values.

In addition, maintaining engagement with Chinese consumers—the largest market for most of the luxury products—will remain critical. However, as geopolitical tensions escalate between China and the West, doing so may become more difficult, and with local Chinese brands like jeweler Chow Tai Fook gaining greater scale, Western brands may face a more competitive environment.

2. AGILITY

Relevance is important for the immediate future but having a robust supply chain and a product cycle that can react and change in the face of uncertain market demands is becoming essential.

As luxury companies have closed their retail stores around the world, the rigidity of their sales model, which depends on physical traffic and is characterized by high fixed costs, is on dramatic display. The future challenge will be to reimagine the role that can be played specifically by ‘bricks and mortar’ to fuel recovery and further develop brand advocacy. While the practicalities of high street shopping have significantly changed for health and safety reasons, the highest level of personal in-store customer service and experiential moments will still have a role to play alongside digital transformation.

Digital commerce does not reach 15% of sales at even the most-advanced brands, averaging about 5% across the industry. Therefore, there is tremendous potential for growth of the online channel—especially in Asia. That sales model rigidity is evident in other aspects of operations as well. With 16 to 18 months of lead time needed for the development, production, and marketing of seasonal collections, interventions can be launched only for seasons in development, with impacts to P&L five or six months later. For collections already in production, with orders from suppliers signed months in advance, options are limited and would affect critical suppliers financially.

Shortening the traditional fashion calendar has long been a top priority for many managers who want flexibility in order to adapt to trends or changing market conditions. Companies may find they can increase their responsiveness and turnaround times by deepening their integration with certain decision making—such as in the areas of materials management or fitting—or by delegating decision making to key strategic suppliers. Reductions in the number of annual collections, as has been proposed by Gucci and Saint Laurent, could also ease pressure on designers and help address sustainability concerns.

CREATE CERTAINTY IN THE SUPPLY CHAIN

Supply chains too have been exposed as areas of weakness. Luxury companies have traditionally limited their suppliers in order to maintain product control, ensure minimum threshold volumes, and limit counterfeiting. Regional concentrations of skilled artisans as well as the necessity for made-in labeling for many consumers—also limit diversification options. Localized supply crises are therefore much more difficult to mitigate. And in an environment in which many suppliers are facing bankruptcy, a careful risk assessment—beyond the current crisis—is warranted that examines such vulnerabilities as single-source suppliers, geographic concentrations, and financial health. For situations when critical suppliers are in jeopardy, companies can consider extending credit or accelerating payments in order to keep them afloat.

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3. ENDURANCE

Building and perpetuating an enduring brand is every luxury company's goal. And optimizing cost structures, supply chain relationships, operations, channel mix, and direct relationships with consumers can help maintain efficiency and profitability into the future.

Further consolidations in the industry are likely. The best-capitalized companies, including LVMH and Kering will emerge first and strongest and looking for opportunities. As this article goes to press, it seems likely that LVMH will proceed with its acquisition of Tiffany & Co. The remaining independents will likely be reevaluating their market positions, cash reserves, and near-term revenue prospects, although that may take some time. After the 2008 financial crisis, deal making didn't pick up until 2010, with Kering acquiring Girard-Perregaux and LVMH taking over Bulgari.

Private equity has also increased its investments in this industry. For example, Carlyle currently owns several luxury brands in its portfolio, including Italian footwear company Golden Goose. Further market volatility and the need for capital investments in digital transformation may see investments in this space increase further.

Even in luxury, consumer behavior is shifting. Aspirational consumers have less income. Concerns about sustainability are taking greater precedence. Online channels' market share will only grow. Therefore, to build an enduring future, luxury brands must improve their reliance on consumer insights as a critical aspect of business strategy and product development. Moreover, increases in digital interactions and measurable engagement will lead to an even greater ability to understand consumer behaviors and needs and build deeper consumer engagement. Luxury goods companies should improve their abilities to capture data and drive relevant consumer interactions while at the same time harmonizing analytics, strategies, and operations to work in concert. Such harmonization of data and analytics can help tailor companies' communications, products, and services to changing consumer demands.

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ABOUT US

For nearly forty years, AlixPartners has helped businesses around the world respond quickly and decisively to their most critical challenges–circumstances as diverse as urgent performance improvement, accelerated transformation, complex restructuring and risk mitigation.

These are the moments when everything is on the line–a sudden shift in the market, an unexpected performance decline, a time-sensitive deal, a fork-in-the-road decision. But it's not what we do that makes a difference, it's how we do it.

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Our approach enables us to help our clients confront and overcome truly future-defining challenges. We partner with you to make the right decisions and take the right actions. And we are right by your side. When it really matters.