The Economist

SPECIAL REPORT
LUXURY
DECEMBER 13TH 2014

Exclusively for everybody

Exclusively for everybody

The modern luxury industry rests on a paradox—but is thriving nonetheless, says Brooke Unger

AT THE TRANG TIEN PLAZA shopping mall in Hanoi, Vietnam's capital, on some evenings a curious spectacle unfolds. Couples in wedding finery pose for photographs in front of illuminated shop windows, with Salvatore Ferragamo, Louis Vuitton and Gucci offering the sort of backdrop for romance more usually provided by the sea or the mountains. The women are not wearing Ferragamo's Vara pumps, with their distinctive bows, or toting Vuitton's subtly monogrammed handbags. They cannot afford them. Tran Van Cuon, who assembles mobile phones at a Samsung factory, posed with his fiancée in a brown suit and bow tie that cost him the equivalent of $150. Some day he hopes to become a customer in the mall. Until then, he will proudly display the photos in his home.

To stumble across an outpost of European luxury in a relatively poor and nominally socialist country is not all that surprising. Luxuries such as silk have travelled long distances for many centuries, and even modern luxury-goods makers have been pursuing wealth in new places for more than a century. Georges Vuitton, son of Louis, the inventor of the world's most famous luggage, showed off the company's flat-topped trunks (better for stacking than traditional round-topped ones) at the Chicago World's Fair in 1893. The oil-rich Middle East has been a magnet for expensive foreign trinkets since the 1960s. The Japanese became insatiable consumers in the 1970s. Today, two in five Japanese are thought to own a Vuitton product. And now it is China's turn to lap up luxury.

As luxury-goods sales have expanded geographically, they have also spread across the social scale. When Coco Chanel created her No. 5 perfume in the 1920s she reserved it for her best couture clients, but in the following decade she sold it in smaller bottles so that more women could afford it. Cartier's "Les Must" jewellery in the 1970s put the brand within reach of consumers who could only yearn for Panthère necklaces and Tank watches. Many other brands followed Cartier's *sortie du temple* (descent from the temple), seeking to broaden their appeal while retaining their cachet. Not all succeeded.

Over the past 20 years the number of luxury-goods consumers worldwide has more than trebled to 330m, according to Bain & Company, a consulting firm. Their spending on expensive jewellery, watches, clothing, handbags and so on has risen at double the rate of global GDP. Most of these new buyers are not the very rich but the merely prosperous, with incomes of up to €150,000 ($188,000). Shares of listed luxury companies have far outperformed those of other companies (see chart, next page).

Consumers' rush to quality has created billionaires at a rate that Silicon Valley might envy, especially among the main shareholders of luxury conglomerates that have gathered together many of the best-known ▸▸

ACKNOWLEDGMENTS

In addition to those mentioned in the text the author would like to thank the following: John Ayton, Annoushka; David Baxby, Global Blue; Maria Cristina Buccellati; Charlotte Chiene, Dorchester Collection; Timothy Coghlan, Savills; Edward Bolman, Philips; Liz Flora, Jing Daily; Katja Greisse, Bubstir Art; Nicolas Hieronimus, L'Oréal; Jonas Hoffman, SKEMA Business School; Paul James, Starwood Hotels; Joshua Kane, Bespoke; Andrew Keith, Lane Crawford; Robert Lafrance, Bloomberg; Marcus Margulies, Marcus Watches; Mario Ortelli, Sanford C. Bernstein; Manfredi Ricca, Interbrand; Antoine de Riedmatten, Deloitte; David Sadigh, Digital Luxury Group; Roberto Stern, H. Stern; Elisabeth Walker, James Purdey & Sons.

CONTENTS

A list of sources is at **Economist.com/specialreports**

An audio interview with the author is at **Economist.com/audiovideo/specialreports**

The future of luxury

Experience counts

Providers of luxury need to offer more than expensive baubles to take advantage of a growing market

"TEN YEARS AGO you would have auctioned handbags." Ben Elliot, the boss of Quintessentially Group, a concierge service that helps the rich organise their lives, is explaining a shift in the way that money is raised for charity. These days a kickabout with David Beckham, or perhaps a cycling trip from Venice to Rome, would be more effective: "It's about the bragging rights of doing something others can't do," he says.

If sophisticated consumers are shifting their preferences from handbags to handlebars, makers of luxury goods need to pay attention. The rich set trends, and their notions of luxury trickle down. European consumers now "put more value on inward things", Mr Elliot thinks. Revenues of upmarket hotels this year are expected to grow by 9%, four times the rate of luxury-goods sales. Even the Chinese are tilting a bit from having to being: during this year's Golden Week, an autumn season of concentrated consumer frenzy, the number of transactions in shops was 30% up on last year but that in restaurants and hotels rose by 52%, according to UnionPay, a payment-card company.

What qualifies as an experience people are prepared to pay for is also changing, to something more elaborate, more private and sometimes even stripped almost bare of conventional comforts. David Leppan, a South African-born millionaire, is not much interested in conventional luxury, but reckoned that a recital by Plácido Domingo at Seville's Alcázar palace, arranged by NetJets, a firm that hires out private planes, was "pretty much priceless". Mr Elliot's colleagues at Quintessentially cite the Antarctic Ice Marathon as the sort of activity its clients appreciate. Swish hotels nudge guests away from the familiar to the authentic. "Luxury can be the absence of strawberries in wintertime," says Frank Marrenbach, who runs the Oetker Group's chain of hotels. His chefs prefer to offer seasonal fruit.

In a YouTube video for Johnnie Walker Blue, a top-of-the-range whisky, two friends (played by Jude Law and Giancarlo Giannini) swap ownership of a beautiful old sailing boat on the basis of unlikely wagers. If ownership does become separate from enjoyment, makers of luxury goods will have something to worry about. That moment may not have arrived yet, but as consumers become more sceptical, more discriminating and more interested in experiences, it is coming closer.

It is not as though the rich have stopped buying stuff. The average billionaire owns $6m-worth of luxury goods, not to mention yachts worth $22m, according to Wealth-x, a research firm founded (and later sold) by Mr Leppan. But increasingly such purchases form part of an experience. In the video Mr Law needs a new made-to-measure suit for the dance that will win him the bet on the boat. Savoir Beds, a British firm, is making a rotating bed for the new owner of a French château so that he can enjoy the view both of the surrounding countryside and of the fireplace on the opposite wall. Sellers of less bulky luxuries who make bespoke products for their best clients often add events to their offering. Ferragamo, the Italian shoemaker, treated its favourite Chinese customers to a trip to its workshop in Florence.

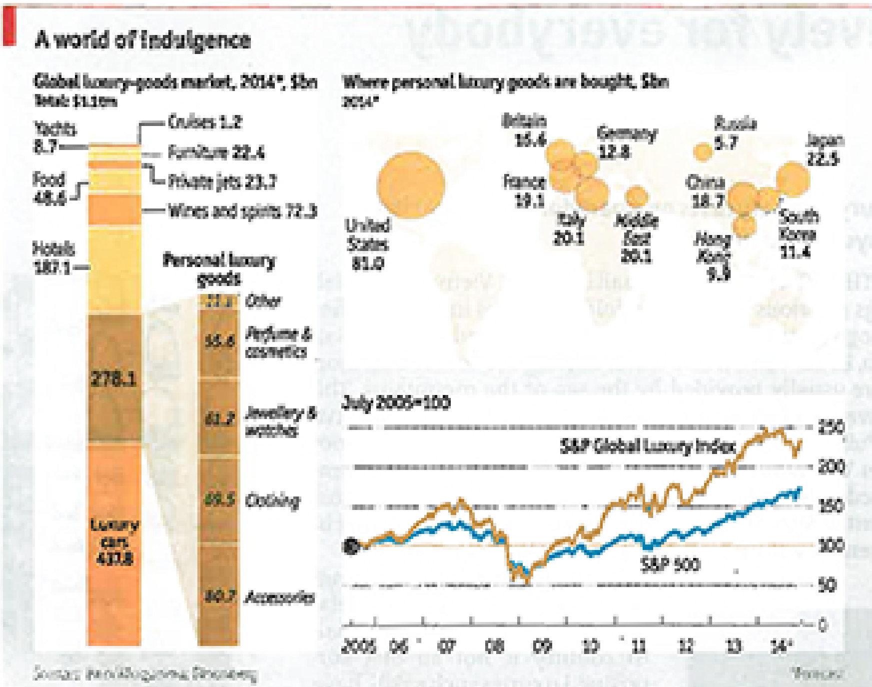
Make it special

Most consumers are not in that league. More than a third of luxury handbags sell for less than €500. The ranks of people who covet such goods are destined to grow; once hooked, they will trade up. Globally, McKinsey expects the number of big-city households in emerging markets with incomes of more than $70,000 a year to treble by 2025.

Makers of luxury have come to realise that the paradox of industrial craftsmanship can be pushed only so far. To captivate new clients and keep the older ones on board, brands will have to invest shopping with a sense of occasion and give ordinary customers some of the individual attention they have lavished on their biggest-spending ones. Increasingly, that is what they are doing. When Burberry launched a perfume in September, it gave customers a chance to inscribe bottles with their own initials, both in shops and online.

Consumers still want to hear the story that luxury tells, perhaps more than ever as the world comes to seem more rootless and mass-produced. In London's Savile Row a small crowd of men and women, nattily clad in mid-20th-century garb, recently staged a demonstration against two shops selling clothes by Abercrombie & Fitch, an American fashion chain. "Give Three-Piece a Chance," demanded their placards. To the demonstrators, the intruder was the antithesis of Savile Row's made-to-measure tailoring. "We're not proper Savile Row-type people," said the protest's organiser, Gustav Temple, who edits an obstreperously nostalgic magazine called The Chap. "But we hope to be one day." The brides of Trang Tien Plaza would understand. ■

Just for you and me



brands. They include Bernard Arnault, a French tycoon who controls LVMH, owner of Louis Vuitton, Moët & Chandon champagne and a host of other brands, and his rival François-Henri Pinault, whose Kering group owns Gucci, a big Italian leather-goods maker. Nick Hayek's Swatch Group and Johann Rupert's Richemont (Cartier's owner) are powerhouses in watches and jewellery. Among the owners who have made fortunes from selling stakes to investors in the past few years are Brunello Cucinelli, whose eponymous company makes casual-chic clothing at serious prices, and Remo Ruffini, a fellow Italian who floated Moncler, a maker of down jackets.

Personal luxury goods are just one small corner of this empire of opulence. Upmarket options can be found in industries from health care to banking, though most analysts leave such things out of their reckoning. Using consumers' own perception of what constitutes luxury goods and services, the Boston Consulting Group reckons that $1.8 trillion was spent on such items in 2012. The biggest category is travel, followed by cars and then personal luxury goods. Bain comes up with a smaller sum for a similar spread of sectors (see chart). But luxury's boundaries are fuzzy and hotly disputed.

This special report will concentrate on personal goods, which face the tricky task of trying to achieve global scale while maintaining the artisan roots that give them rarity appeal. Ultra-expensive cars will make only a brief appearance, and yachts will just sail by on the horizon: globally, only 14,000 people are able to afford a really big one. But the report will include such fast-growing "experiential" sectors as hotels and wine, which are growing faster than things to buy and own.

To view the world through the lens of luxury is to see it subtly altered. Some of the normal rules do not apply to luxury-goods makers, even though in many ways they are similar to other consumer-goods companies. The cost of production is not usually a prime concern and capital investment is generally modest, except for watches. A really prestigious item can be a "Veblen good", named after an American economist born in the mid-19th century who noticed that demand for some goods actually rises as they get more expensive because they confer yet more status. And the margins even on lesser luxury goods are much better than on mass-market items.

Luxury companies like to set their own agenda. Their creative directors oversee both the development of new products and the way they are presented in magazines, shop windows and online. "We are not going to let people influence the vision," says Patrick Albaladejo, deputy managing director of Hermès, a French luxury house so august it claims not to have a marketing department.

Luxury companies often get the most attention for the things they sell least of. Karl Lagerfeld, Chanel's creative director, made headlines this year by sending his models down a catwalk decked out as a grocery shop. But "the bread and butter of the company are chemicals," explains Armando Branchini of the Altagamma Foundation, which represents Italian luxury firms. Luxury perfumes and cosmetics are thought to account for over half of Chanel's business.

Diageo, a big drinks company, has a "Reserve" division that gives special attention to its priciest tipples, such as Johnnie Walker Blue Label whisky. They are marketed through the patient cultivation of the coolest bars and influential "advocates". "You need to be a black belt in relationships when it's about luxury," says James Thompson, who runs the division.

Luxury's lens does odd things to the map as well. Europe is still the pre-eminent maker; its brands account for 70% of the world's luxury consumption. Germany matters in cars and yachts, but the real powerhouse is Italy, which serves as the workshop for French fashion and leather goods as well as its own. Luxury is "one of the few industries where Europe has a sustainable competitive advantage", says Michael Ward, managing director of Harrods, a posh London department store. America is both an underexploited market, given its wealth, and a base for brash competitors such as Coach, Michael Kors and Kate Spade, which are challenging established European brands with a more affordable take on luxury. China, already a voracious consumer, is just beginning to stir as an exporter.

The pope doesn't wear Prada

Of late, though, the champagne has gone a bit flat. The war in Ukraine and the sanctions imposed on Russia in response have put off rich citizens of that country, among the giddiest new consumers. The Japanese went on a spree early this year ahead of a rise in value-added tax, then stopped spending. The Ebola epidemic in Africa and pro-democracy protests in Hong Kong, where Chinese mainlanders do much of their shopping, have unnerved consumers. Most important, slower economic growth and the anti-corruption campaign mounted by Xi Jinping, China's leader, have dampened the spirits of Chinese shoppers, who now account for nearly a third of the global demand for personal luxury goods. The share prices of recently listed luxury companies have fallen by a quarter this year. After two decades when annual growth averaged nearly 6%, the rate this year will be just 2%, predict Bain and Altagamma.

These passing crises come on top of more profound changes. One of them is a shift from "having" to "being", especially in rich countries, where the well-off are becoming less keen on owning and more interested in experiencing things. Consumers in China are turning from monogrammed showiness to subtler elegance. Younger people everywhere have their own ideas about how to consume luxury, helped by social media and e-commerce. Inequality is a growing concern from Berlin to Beijing. Last year a pope whose red shoes were widely (but wrongly) thought to have been made by Prada, an Italian fashion house, gave way to one who shuns the Apostolic Palace for a guesthouse. That captures the mood and contributes to it.

Sobriety has bypassed some sectors, including fine wine and expensive cars. Yacht sales, too, are buoyant again after a period in the doldrums in the late 2000s, and today's yachtsmen often add a helicopter or two to their order. But mostly substance is winning over style.

In some ways, today's preoccupation with sustainability plays into the hands of luxury-goods makers. With their ample margins, they can afford to reduce the environmental damage they cause. "Luxury can show the path that answers the major issues of our century," argues Marie-Claire Daveu, Kering's sustainability chief. By and large, makers of luxury goods employ European workers rather than sweatshop serfs in Bangladesh. The key trend now, says Diageo's Mr Thompson, is "away from show for its own sake towards knowledge, appreciation, craft and heritage—something with a story." ■

Definitions

A rose by many names

Why luxury is so hard to pin down

WHAT EXACTLY IS luxury? The concept is both slippery and divisive, not least because so many purveyors wish to lay claim to it. It is adjacent to excess, enjoyment of it may bespeak shallowness, and those who possess it are often undeserving. Luxury makers need to dissipate such doubts.

As luxury has become more widespread, defining it has got harder. The language associated with it is replete with qualifiers. It can be "authentic", "absolute", "aspirational" or "affordable". Jean Cassegrain, the chief executive of Longchamp, a leather-goods and clothing company, positions his "optimistic luxury" brand between affordable Americans such as Coach and the more upmarket Louis Vuitton. Parts of this universe, like *haute couture* and *haute horlogerie* (the watchmaking version), have organisations to back them up, but they leave a lot out, such as ready-to-wear clothing. Altagamma, which produces annual re-

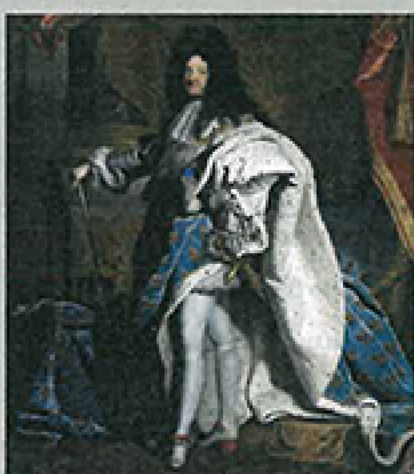
Saintly or sinful?

Appreciation of luxury goes in circles

LUXURY HAS A long pedigree. Homer's warriors slaughtered each other for booty as much as for glory. Priam, the Trojan king, assembled "twelve robes, handsome, rich brocades" and "a magnificent cup the Thracians gave him once" as part of a ransom for the return of the body of his fallen son, Hector. More often, though, luxury has been portrayed as a menace to martial spirit and moral fibre. Christians associated luxury with sinful self-indulgence. In the rose window of Notre Dame, luxury is represented "as a woman titivating herself in front of a mirror", says Christopher Berry in his study "The Idea of Luxury", published in 1994.

Sumptuary laws were devised over the centuries to discourage dissipation, curb imports of expensive fripperies and (often hypocritically) preserve distinctions of rank. Those of the Aztecs were particularly tough: *macehualtin*—members of the labouring class—who displayed finery and precious objects could be put to death. The Venetian republic had three *provveditori alle pompe*, luxury police who ensured that sumptuary strictures were observed. Rules in the Tokugawa (Edo) period in Japan specified what sort of toys parents could give their children.

Attitudes changed with the Enlightenment and the advent of liberal economics. In the 1600s British merchants rejected "bullionist" arguments that the import of luxury goods weakened the economy by depleting gold reserves. A century later Adam Smith and David Hume portrayed luxury as a spur to industry and to social co-operation. It is "peculiar" to "polished and...luxurious ages" that "industry, knowledge and humanity are linked together by an indissoluble chain," wrote Hume in his essay, "Of Refinement in the Arts" (originally called "Of Luxury"). Samuel Johnson introduced a feelgood factor to the enjoyment of luxury: "You cannot spend money in luxury without doing good to the poor." For these thinkers, luxury was all tied up with commerce, liberty, peace and social mobility.



Sun King and supermodel

At the time they were writing, the French had already laid the groundwork for the modern luxury industry. Jean-Baptiste Colbert, Louis XIV's finance minister, taxed imports, offered subsidies and enforced quality standards to promote French production of the sumptuous textiles and lace that were *de rigueur* at the Sun King's court; then he pushed exports. "Fashion is to France what the gold mines of Peru are to Spain," he proclaimed. But Elisabeth Ponsolle des Portes, boss of the Comité Colbert, France's club of luxury producers, says the country's luxury know-how goes back to the troubadours of the 12th century.

Thorstein Veblen, the economist who gave his name to the sort of goods that become more desirable as their price rises, had political grounds for sneering. Luxury was a form of waste that arose to confer status on an essentially useless class, he argued in "The Theory of the Leisure Class", published in 1899. "Conspicuous consumption of valuable goods is a means of reputability to the gentleman of leisure." Both Veblen's and Hume's ideas remain potent.

ports on luxury along with Bain, applies a simple price standard: a luxury handbag costs €850 or more.

But that leaves the question of why you might want to spend that kind of money. Brunello Cucinelli, who turned his idea of enlivening cashmere with bright colours into a clothing business with revenues of €322m and a stockmarket capitalisation of around €1 billion, provides one answer. He runs his company from Solomeo, a timeless village perched on an Umbrian hilltop. There, Mr Cucinelli has set up schools dedicated to crafts such as tailoring and gardening and a "neo-humanist academy".

Mr Cucinelli considers his products to be "absolute luxury", and not many would disagree. A men's cardigan knitted from Mongolian cashmere can cost more than €1,600, not least because it is made in his hilltop Utopia. Italian manufacture is not merely an assurance of quality; without it the business would lose its point, Mr Cucinelli suggests. Europe is of "inestimable value" to the company and, he believes, to its customers. He adds to the aura by insisting that his workers take a 90-minute lunch break. With Mr Cucinelli selling it, that cardigan will feel as good to the soul as it does to the touch.

All luxury makers like to tell some version of this story, and some have longer histories. Breguet, part of Switzerland's Swatch Group since 1999, boasts that Napoleon was one of the "most faithful clients" for its watches. Karl Lagerfeld, a pony-tailed German fashion designer, is the spiritual son of Coco Chanel. Burberry, which was founded in 1856, calls itself an "old new company". It is "the combination of timelessness and modernity [that] makes these brands successful", says Mr Arnault of LVMH.

Tell me a story

Craft and a sense of place are almost always part of the narrative. Hermès attractively defines luxury as "that which can be repaired". The company keeps expatriate repairers in centres such as New York, Shanghai and Tokyo. Vertu, a company that makes handsets costing ten times as much as an iPhone, justifies the price by pointing out they are "handmade in England".

For some of the most discerning customers, the products of pretty much any company you have ever heard of fall short of real luxury, which is defined by extreme rarity. Breguet produces perhaps 15,000 watches a year. Greubel Forsey makes a mere 100, one for each employee. Rolls-Royce makes 4,000 cars a year, many of them to order. But they are commonplace compared with the 38 that will roll out of the "atelier" of Pagani, an Italian manufacturer, this year. The quality of such "meta-luxury" objects may be no better than those produced by slightly less exclusive marques, but they come over as more intimate and closer to their creators.

At the other end of the scale, companies bristle when their credentials are questioned because their prices are less exalted or they manufacture in China. Coach, which mainly sells leather goods, uses the same materials as European brands, but its soul is in New York, its creative hub. Manufacture is a collaboration between designers there and craftsmen in China, says Coach's boss, Victor Luis. He thinks the idea that luxury and approachability don't go together is "almost offensive". Similarly, Longchamp's Mr Cassegrain argues that it is "almost racist to characterise made in China as bad".

The broad conclusion from all this may be that luxury is in the eye of the beholder. To qualify, it seems to demand a stretch from those who would claim it. For the rich, that exertion may take the form not of scattering money but of spending time or learning about an object or an experience. The acquisition of luxury is both an attempt at transcendence and an act of appropriation, like the picking of the apple in the garden of Eden. Perhaps that was mankind's first luxury good. ■

The business case

Beauty and the beasts

Think global, act artisan

YOU MIGHT EXPECT the headquarters of LVMH on the Avenue Montaigne in Paris to show off its full range of brands, from Sephora (cosmetics) to Moët & Chandon (champagne). They do get some play in a small museum housed in the lobby. But up on the ninth floor, where Mr Arnault presides over his luxury empire, there is tribute to just one, Louis Vuitton. Two paintings of the LV monogram by Takashi Murakami hang opposite the reception desk, and a little pyramid of handbags sits nearby.

The decor tells you something about Mr Arnault's group. Louis Vuitton is the company's biggest brand by far, accounting for about a third of its sales and nearly half its profit. A Louis Vuitton shop window is the first close encounter with luxury for many people, and the brand often pioneers new markets. Its first shop in China opened in 1992. It is "the number one brand in the world and will stay so", Mr Arnault declares.

Critics sniff that canvas creations like the Neverfull tote, spangled with logos and sold by the hundreds of thousands, are commodities, not luxury. "It's difficult to say you're a luxury brand if everyone on the planet can buy your product," says Barbara Coignet of 1.618, an organisation that promotes luxury with an environmental and social conscience. Misgivings about excessive scale extend to the publicly listed companies that own the brands, such as LVMH, Kering and Swatch. "Real luxury is slowly fading away because of the big luxury groups," complained Lapo Elkann, an Italian entrepreneur, at a recent *Financial Times* conference on luxury. "They standardise the aesthetics of brands to generate more profits for shareholders."

The holding-company model is not the only successful one. Chanel belongs to the secretive Wertheimer family; Hermès is publicly traded but managed by its founding family. Both have largely avoided the criticism that bedevils Big Luxury. Italy's lux- ››

Biggest and best 1

European luxury firms

	Selected brands	Main products	Total sales 2013, $bn
LVMH	Louis Vuitton Moët & Chandon Bulgari Guerlain	Leather goods and fashion Champagne Jewellery Perfumes	36.38
RICHEMONT	Cartier Van Cleef & Arpels Net-A-Porter Piaget	Watches and jewellery Jewellery Online fashion Watches and jewellery	13.29
KERING	Gucci Boucheron Bottega Veneta Yves Saint Laurent	Leather goods and fashion Jewellery Leather goods and fashion Fashion	12.17*
swatch	Breguet Blancpain Omega Harry Winston	Watches Watches Watches Watches and jewellery	8.50
HERMÈS		Leather goods, accessories, fashion and jewellery	4.49
PRADA		Leather goods and fashion	4.48†
BURBERRY		Fashion and accessories	3.65‡

*40% of sales from luxury †Year to end Jan 2014 ‡Year to end March 2014

Sources: Company reports; *The Economist*

ury houses are mostly stand-alone companies, controlled by their founding families even when they are publicly traded and professionally managed. Young firms often try to keep their distance from the big groups, either turning to private-equity investors or staying independent. British brands are "very reluctant to take outside investment", says Michelle Emmerson, chief executive of Walpole, an association of British luxury firms.

The soft-spoken Mr Arnault has become France's richest man by overcoming such resistance. His career in luxury began in 1984 when he picked up Dior, a venerable *haute couture* house, in the bankruptcy sale of an industrial group. A few years later he wrested control of Louis Vuitton from Henry Recamier, who had married into the founding family and expanded the brand's two shops into a network of 125. Other *maisons*, such as Céline and Givenchy, followed into Mr Arnault's clutches. With Dior and Louis Vuitton he took production and distribution back from licence- and franchise-holders to boost their cachet.

In 1999 he lost a battle for control of Gucci to his arch-rival, Mr Pinault. Mr Arnault's stealthy acquisition of a stake in Hermès, revealed in 2010, appalled conservative Parisians. His interest was purely financial, he insisted; in September he agreed to distribute the shares to LVMH's investors, giving them (and himself) a handsome profit. But his image as a monogrammed Machiavelli persists. "Arnault never met a brand he liked that he didn't want to make bigger," comments Hélène Le Blanc, a luxury-industry consultant.

There are good reasons for bigness, both for brands and for the companies that own them. Listed European luxury groups have expanded their global market share from 39% to 42% over the past five years whereas independents' share has dropped from 50% to 43%. Luxury, ironically, benefits from economies of scale. The Swatch Group dominates Swiss watchmaking, with a 45% market share, in part because the industry involves large investments and high fixed costs. Cosmetics are the most high-tech part of luxury and their distribution is more akin to that of detergent than of jewellery, so most brands license that side of their business to specialists such as L'Oréal and Procter & Gamble.

There are good reasons for bigness, both for brands and for the companies that own them

In "soft luxury" categories like handbags and clothes, where production is low-tech and costs are variable, the benefits of scale are in retailing and marketing. Key money paid up front to open a shop can cost up to £10m ($16m) on London's Bond Street; the cost of fitting it out comes on top of that. Annual rent can be £1m. A big brand, or one belonging to a strong group, can wait to break even. A small one risks bankruptcy if sales sag, says Mr Branchini of Altagamma. To secure prime space in shopping malls, it helps to belong to a holding-company convoy led by a large brand.

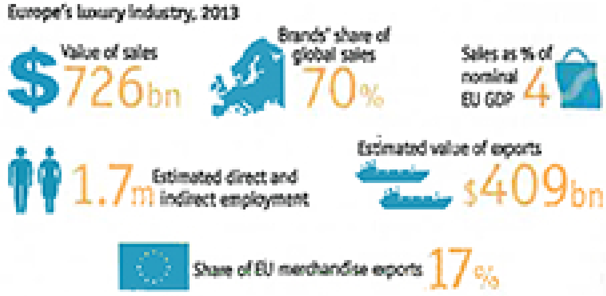
Perhaps equally important is the big groups' clout with publishers of glossy magazines and "key opinion leaders" whose fashion-packed blogs, videos and Instagram streams reach millions of followers. Media spending is correlated with traffic in stores, so large brands can open bigger and better ones. Luca Solca of Exane BNP Paribas, an investment bank, has dubbed this the "mega-brand virtuous cycle". Most big companies have become retailers in their own right. This gives them better margins, along with control over the presentation of their wares and markdowns on unsold stock. By this measure, Louis Vuitton is ahead of the others: it sells only through its own network of 462 points of sale.

In theory at least, the groups help the smaller brands they acquire to grow faster. Under Kering's tutelage Bottega Veneta, an Italian leather-goods maker renowned for the woven *intrecciato* of its handbags and shoes, has gone from being a niche brand to revenues of more than €1 billion. Kering encouraged Christopher Kane, a British fashion designer who is part of its stable, to open his own stores, and guided Italy's Brioni to move out of women's wear and into men's accessories and shoes. Small brands also benefit from centralising the boring bits of the business, such as logistics. The brightest prospects in the industry are for "small brands in big conglomerates", says Julian Easthope of Barclays Capital, an investment bank.

Mr Arnault thinks LVMH's main contribution to its *maisons* is its ability to recruit talented managers. In stand-alone companies "a bright person is rapidly blocked," he says. At LVMH he or ▸▸

Serious money 2

Europe's luxury industry, 2013



Source: Frontier Economics, ECCIA

she can move from fashion to jewellery to wine. The groups are looking for productively split personalities, with "the capacity to be inspired by creativity in a rational way", as Mr Arnault puts it. Kering is on the lookout for similar qualities. "When the fashion show is over, the business side takes over," says Jean-François Palus, its managing director.

Occasionally this gets out of hand. The point of the big groups is to foster profitable growth, but too much of it or the wrong sort can tarnish a luxury brand. In 2004 Gucci set itself a goal of doubling its sales within eight years. To achieve that, the company produced many more canvas double-G-dappled handbags than was healthy for the brand.

The trick is to polish a brand to a high sheen and then to disseminate the glow through the full product range without letting it dull. Hermès and Chanel have lately been better at this than the big groups' main brands. That is not because they are small: Hermès has 315 stores and €3.8 billion in revenue, and Chanel's sales are three-quarters the size of Louis Vuitton's. But each has its own knack for teaming exclusivity with accessibility.

Managing the mystique

Hermès starves the market. Customers have to wait six months or more to buy its most famous products, its Kelly and Birkin handbags, each one handmade by a single craftsman. Although Hermès makes an estimated 70,000 Birkins a year, prices on the secondary market can be 50% above the retail price. Hermès's growth is limited by the scarcity of high-quality raw materials and of craftsmen, who take two years to train up, points out Mr Albaladejo. Hermès sells plenty of less expensive products, including scarves, wallets and towels. But €500 will merely buy you an expensive scarf, not a cheap handbag.

Chanel will not sell a handbag for much less than €2,000 but moves millions of €30 lipsticks. Few brands stretch as gracefully from mass production to *haute couture*. Many of its cosmetics are made by Intercos, a contract manufacturer, but the company also provides a haven for endangered crafts still vital to the most exalted tiers of fashion. Paraffection, a subsidiary, houses century-old firms that specialise in things like embroidery and making artificial flowers, both for Chanel and other brands. The husbandry practised by Hermès and Chanel contrasts with the approach taken by Italy's Giorgio Armani, whose half-dozen sub-brands each sell similar products at different prices.

LVMH and Kering have both been burnishing their biggest brands lately. Since a strategic review in 2010, Gucci has reduced sales of its cheapest handbags from a third of the total to less than 5%. Mr Arnault, for his part, announced an "adjustment to the strategy" last year which involved a big reduction in new store openings and a greater emphasis on leather products. Customer service was also beefed up. These moves to higher ground have slowed the big brands' growth and conceded territory to lower-priced competitors. "When Vuitton and Gucci move upmarket, that makes more space for us," says Longchamp's Mr Cassegrain.

But fast-growing smaller brands seem unlikely to eclipse Louis Vuitton. "People said in 1989 that Louis Vuitton was already too big. Now it's ten times the size," says Mr Arnault. He is as ambitious for it as ever. A dazzling new arts centre in Paris designed by Frank Gehry, called the Fondation Louis Vuitton, opened amid a flurry of publicity in October. In a riposte to those who see the LV monogram as a vulgar status-seeking symbol, the company commissioned six "iconoclasts", including Mr Gehry, to come up with playful new designs for it. Mr Lagerfeld (who is creative director of LVMH's Fendi label as well as of Chanel) cheekily devised a punchbag with matching gloves and a trunk to house them. The designs are now on display at most of Louis Vuitton's flagship stores, including the one in Shanghai. ■

China

Beyond bling

Tastes are changing, but appetites remain keen

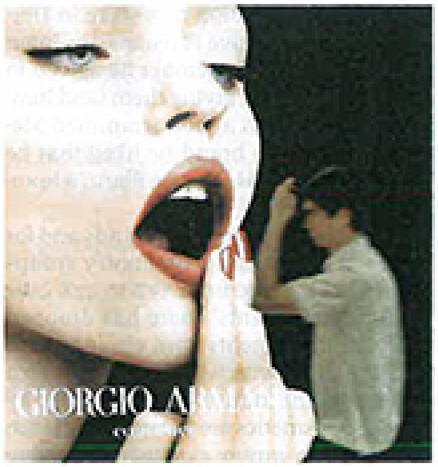
IF LUXURY MEANS Bond Street or the Place Vendôme for you, Hong Kong comes as a shock. Billboards touting Swiss watches and Italian shoes dominate the skyline. At shopping centres, high-wattage façades compete for space. Louis Vuitton's lights square up against Burberry's cinema screens.

This Vegas-like glitter reflects the novelty of luxury in China, and the country's new importance to luxury. Today nearly one-third of all personal luxury goods sold worldwide are bought by Chinese consumers. Their spending is divided more or less equally among the mainland, the Chinese-speaking territories of Hong Kong, Macau and Taiwan, and the rest of the world. Mainlanders become familiar with the brands through marketing and shopping centres at home. When they visit Hong Kong they are "on a mission", says Pascal Perrier, chief of Burberry's Asian operations. The gaudy signage helps guide them to shopping destinations they have already picked out.

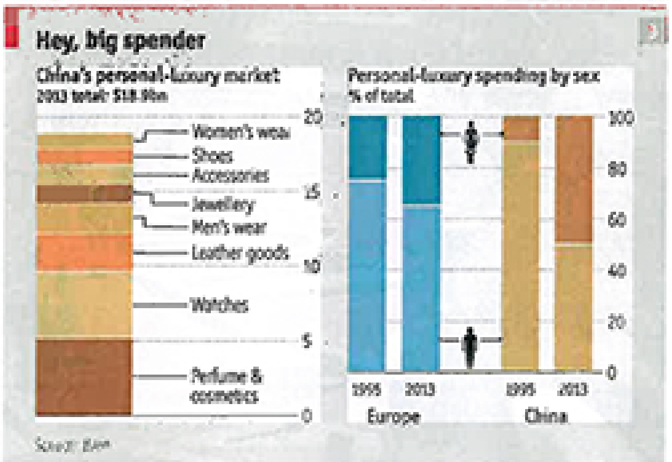
Chinese shoppers came to the rescue when the financial crisis in 2008 cast a pall over luxury. Since then 70-80% of global growth in the sector has come from China, according to Barclays Capital. Once-fading European brands, such as Britain's Aquascutum, which makes traditional clothing, have sought second lives there. Others, like Lancôme, a cosmetics-maker, are presenting themselves as more luxurious there than they are seen at home. "Now our culture is so imbued and involved in good and bad ways by luxury penetration," says Yi Zhou, an artist who has collaborated with luxury brands. "Instead of the theatre we go to store openings ...I feel like I live in an airport."

The rush to China intensified after the 2008 Beijing Olympics, with luxury brands swarming into shopping malls as fast as they could be built. It was a "game of space invaders", says Erwan Rambourg, a banker and author of a new book, "The Bling Dynasty". President Xi Jinping's crackdown on corruption, along with slower economic growth, has now changed the mood.

His anti-extravagance measures amount to a mini cultural revolution. Chinese newspapers report falling sales of such delicacies as hairy crab and sea cucumber as banqueting halls go ▸▸



Nearly one-third of all personal luxury goods sold worldwide are bought by Chinese consumers



quiet. Hotels have asked to have stars knocked off their ratings. One airline, China Southern, rebranded its first-class cabin "business class". Paul & Shark, an upmarket Italian clothing brand, used to take corporate orders for 300 polo shirts at more than 3,000 yuan ($490) apiece, to hand over as gifts. Those days are over, says Alice Wong of ImagineX, which operates the company's shops in China.

European brands that catered to pre-Xi giving and guzzling suffered most. In the first nine months of this year exports to China of Swiss watches, which had become a common ornament on the wrists of public officials, were more than 10% down on the same period in 2012. Sales at Rémy Martin, maker of $2,500-a-bottle Louis XIII cognac, plunged 13.4% in the half-year to September 30th. A slower economy has also reduced the growth in the number of newly affluent families, defined as those having just entered the income bracket of €15,000-75,000 a year. It dropped from 6m in 2010 to 4m in 2012.

The luxury market in mainland China, worth $18.9 billion in 2013 (see chart 3), will shrink for the first time this year, predicts Bain. Still, few brands are thinking of giving up. Mr Arnault says it will remain "one of the most promising markets". But it is becoming more complex, more sophisticated, more international and harder to navigate.

Luxury in China began as a male-oriented pursuit, centred on liquor and wristwatches, but is now becoming more feminised, with handbags, shoes and fashion featuring strongly. Experienced consumers are graduating from bling to sophistication with a speed that Mr Arnault describes as "spectacular". But many Chinese idiosyncrasies will persist, including a penchant for shopping abroad and a big discount market that mingles the real with the fake. Luxury brands have to work out how to cover that range.

One promising group of consumers is the offspring of the one-child-policy era, born in the 1980s and 1990s. They are the single focus of attention for their parents and often two sets of grandparents, giving them access to plenty of cash. Another, potentially huge, market is women, whose "vision and status" was changed by Mao Zedong, says Pierre Denis, chief executive of Jimmy Choo, whose stilettos featured in "Sex and the City". Their new self-confidence translates into sales. And even if growth rates are slowing, there will still be more people with more disposable income. Spending on luxury by the rich (households earning at least €75,000) will nearly quadruple between 2012 to 2020, according to Exane BNP Paribas. But it will be dwarfed by the spending power of merely affluent households, which will double to €90 billion and account for 70% of luxury consumption.

Veteran consumers are moving from very famous brands to somewhat less familiar ones. In a survey of consumers in Beijing and Shanghai carried out by Bain last year, Hermès and Prada were found to have displaced Louis Vuitton and Gucci among the three brands that consumers wanted most, and Burberry and Bottega Veneta had entered the list of the most popular ten. As shoppers become more price-conscious, affordable American brands are making inroads. Coach is advancing into second-tier cities and Kate Spade is just getting started in China, a "very big opportunity", says its chief executive, Craig Leavitt. A fad for all things South Korean has also boosted brands such as Sulwhasoo

The clamour for glamour

China is not the only growth story

"FOR NIGERIANS," SAYS John Obayuwana, "the bigger the logo the better." Mr Obayuwana owns Polo Luxury Group, a chain of shops in Nigeria and Ghana selling things like Swiss watches and Montblanc pens. His rich initial customers have been joined by middle-class consumers with a penchant for European luxury. Nigeria is a difficult market, with shoddy infrastructure and few decent shopping malls. So for the foreseeable future Nigerians will do most of their upmarket shopping at emporia like Harrods in London, where they outspend Americans. But as emerging countries get more prosperous, they are becoming increasingly important to luxury-goods makers.

The 15 fastest-growing emerging markets will provide 90% of the growth in consumption of luxury beauty products and women's wear over the next ten years, says Nathalie Remy of McKinsey, a consultancy. China will account for nearly half that growth, which leaves plenty of opportunities in other developing countries. Whereas makers of packaged consumer goods must fan out across entire countries to reach their markets, luxury makers can concentrate on the main cities.

South-East Asia is "a half-China", says Mr Cassegrain of Longchamp. For now, the inventor of the folding Le Pliage nylon tote does only 6% of its business in the region, but that is two-and-a-half times as much as three years ago. Half of Latin America's luxury sales are in Mexico, in part because that country has slashed duties on imports. Brazilians, who face higher tariffs, tend to shop in Miami.

Oddly, for all its wealth, even America is a developing market of sorts for European luxury-goods makers. It has 30% of the world's high-net-worth individuals (people with more than $1m in liquid assets) and nearly a quarter of global GDP, but consumes less than a fifth of the world's personal luxury goods, notes Olivier Abtan of the Boston Consulting Group; and its consumers are younger than those in Europe or Japan. North America is "probably the safest growth driver we can imagine", says Michele Norsa, chief executive of Salvatore Ferragamo.

For small luxury houses, it may be better to pursue a modest share of a slow-growing mature market than to leap into fast-growing emerging economies, says Ms Emmerson of Walpole British Luxury. Lots of Europeans own luxury goods but buy them infrequently. Mesmerised by the dynamism of developing markets, luxury brands are turning Europeans off by pushing up prices and churning out stylish but ephemeral designs, argues Ms Remy. Europe could be "a land of opportunity" if only luxury-goods makers would seize it.

(which makes cosmetics).

The shift to niche brands should not be exaggerated. "Only really fashionable girls buy Céline and Fendi bags," says Cheng Yan, whose Shiliupo Report (the name means something like very gossipy grandma) has160,000 subscribers on WeChat, a social-network and messaging service. First handbags are "always with a logo", and Louis Vuitton's remain the most popular.

"Luxury brands had a very easy ride" in China, says Emmanuel Hemmerle, a headhunter based in Shanghai. "Now they have to think." The first generation of luxury-goods managers spent their time negotiating with landlords, who decided which brands would occupy their shopping malls (and gave preference to Vuitton, Gucci and Chanel). The new climate demands executives who are good at visual merchandising and customer service. It is telling that the newish chief of Louis Vuitton in China, Christophe Sadones, has come from the hotel business.

Why pay more?

However tempting the displays at Beijing's Shin Kong Place and Shanghai's Plaza 66, Chinese consumers will do most of their shopping elsewhere. Luxury-goods prices in China are 40-50% higher than in Europe, in part because of high import duties and consumption taxes. The Chinese are keen bargain-hunters, so they buy abroad or on the internet.

Last year the Chinese took some 100m trips outside the mainland, many of them to such destinations as Hong Kong's Harbour City, Manhattan's Fifth Avenue and Milan's Via Monte Napoleone, armed with detailed shopping lists. In Paris, buses bearing Chinese tourists deposit them at Galeries Lafayette, a department store. Two-thirds of Chinese visitors to Britain in 2011 went to Bicester Village, an upmarket discount mall near Oxford. Sightseeing is a secondary concern. Mainlanders in Hong Kong spend 73% of their budget on shopping, says Mr Rambourg.

This is bound to increase. According to Mr Rambourg, currently just 4% of Chinese hold passports, compared with roughly 30% of Americans and 70% of Britons, but numbers are growing by 10m-15m a year. A relaxation of visa rules is likely to lure more Chinese to Britain and America. Swiss watchmakers were puzzled to see a spike in American sales in August, normally a slow time of year; then they realised the buyers were wealthy Chinese dropping off their children at university. Even at home the Chinese shop on the move. Just half of all sales in Shanghai are to local residents.

Stay-at-home bargain-hunters have a plethora of online choices, some of them provided by websites that co-operate with the brands. Mei.com holds "flash sales" of unsold stock; The Outnet, the discount arm of Britain's Net-A-Porter fashion website, serves as an online outlet mall. But most of them come through the murky channel known as *daigou*, which offers genuine products at big discounts to Chinese list prices. The stock may come from independent shops in Europe, or in some cases from the brands themselves, which pass goods on to independent resellers. Agents spirit the goods into China for a fee, usually without paying import duty. Some transactions are arranged through networks of friends but many take place online. Taobao, one of China's main e-commerce businesses, has a website dedicated to *daigou*, g.taobao.com. Up to 30% of luxury sales in China come through this channel, reckons Bruno Lannes of Bain.

Daigou outlets sometimes mix fakes with the real thing, which is why Ms Cheng warns her readers against them. China's commerce ministry has proposed cutting import and consumption taxes to discourage the grey market and boost domestic sales. But in a political climate which frowns on luxury, that is unlikely to happen, so black and grey are likely to remain fashionable colours. ■

Demographic trends

Marques for millennials

Young people choose and buy differently

THE MOST COVETED ticket at London's half-yearly fashion weeks is to Burberry's Prorsum show, where the British trench coat-maker presents its upmarket ready-to-wear clothing. Christopher Bailey, the brand's chief creative officer and CEO, likes to surprise his audience. At the birds-and-bees-themed unveiling of his women's wear for spring and summer 2015, held in September in London's Kensington Gardens, the sartorial novelty was an indigo wasp-waist denim jacket. The digital novelties included a highlights tape on YouTube that let viewers zoom in to focus on various aspects of the show, such as the music. Twitter used the occasion to launch in-tweet purchasing for luxury.

This is a big change from the traditional model of presenting fashion in which designs are conceived at the top, handed down to journalists and buyers at fashion-week set-pieces and pop up in the shops four or five months later. Technology has narrowed the distance between designers and consumers and sparked a conversation. YouTube, Instagram, WeChat and the like have "completely disrupted" the way fashion companies communicate, says Imran Amed, editor of *The Business of Fashion*, an online journal.

This is the first of three technology-induced changes that will profoundly affect luxury brands. The second is a shift from selling in physical stores to online. The third, for now only just visible in the distance, is a technology-related change in the way luxury goods are made.

The digital transition is running alongside a demographic one. By 2026 the main consumers of luxury will be millennials (or generation Y), people born in the 1980s and 90s, says Unity Marketing, an American market-research firm. Brands with pedigrees can use technology to win this age group over, as Burberry is trying to do. Newer ones can employ it to break through.

A study by the Boston Consulting Group reckons that millennials "are geared to pleasure rather than to possessions", mak- ▸▸

Burberry was among the first to spot millennial potential

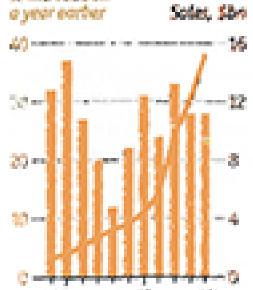
ing them less inclined to buy things. They are assertive, sceptical of authority and nonconformist, none of which bodes well for traditional luxury brands. On the other hand, photo-sharing social media like Instagram put a premium on appearance, argues Mr Denis of Jimmy Choo, which should be a good thing for companies like his. In the same vein, Eric Briones, a French consultant who has written a book about the millennials' relationship with luxury, says they consume it "without remorse".

But not uncritically. Brands must prove that their products are worth the price, not rely on mystique alone. Generation Y-ers tend to be unimpressed by logos but entranced by "codes", subtler ways of conveying a brand's identity. The red soles of Christian Louboutin's shoes and the quilting on Chanel's 2.55 handbags are the sort of signs that young consumers can make their own, says Mr Briones. Unhappy customers can sound off on websites such as styleforum.net. Some millennials also want luxury goods to be made in ways that damage neither workers nor the environment.

Burberry was among the first to spot millennial potential. In the early 2000s Britain's ostentatiously vulgar "chavs" (a particular group of loutish lower-class youths) were sporting the brand's distinctive tartan plaid as their unofficial uniform. It appeared on baseball caps, even dogs. Angela Ahrendts, an American who became the company's chief executive in 2006 (and has recently left for Apple), made the digital courtship of millennials a centrepiece of her strategy for reviving the brand. Today Burberry is unabashedly digital. Two-thirds of its staff are under 30 and use social media to talk both to each other and to Burberry's customers.

Net de luxe

Global online personal-luxury sales



Sources: Barclays; Bain; The Economist
*Forecast

Burberry sees its website and its shops as complementary. It even struck a deal with Amazon to list beauty products on the online retailer's site. In the six months to September 30th Burberry booked a year-on-year rise in revenue of 14%, largely thanks to buoyant digital sales. It recently assumed direct control of its cosmetics and fragrances business, hoping to "disrupt beauty through digital".

Disruption is not something that comes naturally to most established luxury brands, but when they embrace it they sometimes do it well. Creative directors are increasingly targeting millennials. The mission of Louis Vuitton's newly appointed creative director, Nicolas Ghesquière, is to "reboot the monogram", making it less of a logo and more of a code, says Mr Briones.

Live-streaming of catwalk shows is now common practice, as is giving celebrity bloggers front-row seats alongside editors of the main fashion bibles. Brands feed their "communities" with streams of images on Instagram and Pinterest and Hollywood-quality videos on YouTube. Cartier's L'Odyssée de Cartier, starring a bejewelled panther, has been seen 17.6m times.

But the conversation between luxury makers and their public can easily take an awkward turn. Stella McCartney, a designer who likes to display her social conscience, got into trouble when her company's Instagram stream featured a photo of a painfully skinny model. On receiving complaints from fans, her company removed the photo and declared its enthusiasm for people of all colours, shapes and sizes.

Actually selling luxury online is more difficult than talking about it. Even brands that dabble in it doubt that any website can match the experience of shopping in a boutique. "To buy a luxury product you have to touch it," says Mr Arnault. Many companies offer just a small range of their products for digital sale, and some none at all.

But e-commerce is making inroads. Net-A-Porter, a website that pioneered internet sales of upmarket fashion, has a customer base of 6m women and has persuaded some 650 brands to offer their wares on its platform. For now only about 8% of all luxury sales are online, but they are growing at a rate of 25-30% a year, says Claudia D'Arpizio of Bain's Milan office. Much of this is at the expense of independent boutiques. If the share of digital sales goes much above 10%, investment in stores "will be rethought", she says.

Goodbye to Bond Street?

The future is "direct to the consumer through the internet", says Nathan Morse, who runs the business side of Hannah Martin, a London jeweller. It belongs to a new generation of luxury houses with no hang-ups about e-commerce (and not enough money to open a lot of stores). They may have short histories, but they have stories. Hannah Martin's androgynous pieces are fashioned by hand in London.

It used to take 30 years to build a global brand, says Uché Okonkwo-Pézard of Luxe Corp. Thanks to the internet, "now you can become global in 18 months." That has spawned new brands as well as business models. Bargain-hunters can turn to online outlets like The Outnet or flash-sales sites such as vente-privee and mei.com. People who want to hire can try Bag Borrow or Steal or LUXTNT, a Hong Kong startup. Second-hand luxury is available from stylesequel and InstantLuxe. Such services have been around for a long time, notes Stephanie Phair of The Outnet, but they have been "supercharged because of the internet".

The final challenge is to decide how far to incorporate technology into the making of luxury, and perhaps into luxury itself. Iris van Herpen, a Dutch fashion designer, uses 3D printing to construct her garments. Ralph Lauren makes a handbag with a light and a smartphone charger. Suppose machines could stitch Birkin bags better than the craftsmen at Hermès or etch watch dials more finely than Vacheron Constantin's *guillocheurs*? "The big gap between hand work and technology will become smaller and smaller," predicts Ms van Herpen. Luxury can embrace innovation; what it must be wary of is obsolescence. ■