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Not just a rebound, it is set to flourish in the coming decade.

By Erwan Rambourg

The luxury rebound following the Covid-19 pandemic has been more impressive than most would have thought. Scale continues to play an important role, physical stores are back, and while there are some clouds on the horizon, the outlook for the luxury sector remains incredibly positive for the long term. My optimistic outlook for the long term is predicated on the power of three consumer segments that will move the needle for the luxury sector–women, Chinese shoppers, and youth. In addition, the rapid speed of scaling-up and mergers and acquisitions (M&A) should provide a great boost to a post-Covid luxury world.

Three cohorts of consumers and local clientele are powering purchases

FEMALE CONSUMERS

Women are already the key decision-makers for most households. With greater financial autonomy and higher employment participation rates, female spending power will grow. As women get married later and have fewer children, their higher disposable income will support increased luxury spending. There is societal change around gender inequality, and initiatives are under way to improve the economic position of women. They are thus in a position to influence spending in jewellery, cosmetics, handbags, accessories, and much more.

CHINESE SHOPPERS

While observers are nervous following the comments from the central Chinese government around the need for social harmony and "common prosperity",[1] I have little doubt that Mainland China will remain one of the biggest drivers of luxury growth over the next decade.

Four main trends are associated with this projected growth. First, wealth creation will continue to fuel the spending power of the next generation of Chinese shoppers. I anticipate that the number of potential luxury clients will be close to doubling over the next five years. Second, the bulk of growth should come from China itself with four good reasons to shop at HOME: *Harmonisation* of prices, the rapid development of *Omnichannel* buying, the government's *Monitoring* of consumer spending, and increased *Education* about where to purchase genuine luxury products. In the short term, Covid-19 is the accelerator of repatriation of growth to the mainland and Chinese citizens will continue to buy mostly locally over the next 12 months. Third, China's luxury market is becoming one of the most profitable in the world after having been margin-dilutive for years. And finally, the adoption of luxury in other Asian markets is reaching a ceiling, as seen in Japan and Taiwan; getting mature, like in South Korea; or is too small to move the needle for now, as observed in India and Indonesia.

THE YOUTH

Luxury buyers start young for many reasons, but the essential one is human nature and the desire to buy your place in society. In China, the U.S., and the emerging markets, the modal age of such buyers is lower than in Japan or Europe. In the West, youth demographics are increasingly diverse. The young generation of luxury buyers–including, most notably, people of colour–around the world has transformed the luxury industry and will continue to do so, particularly in certain areas. For instance, casualisation, which is a more relaxed way of dressing up, is not a fad–it is a generational shift. Social media is another area, where widespread information and the search for authenticity will put pressure on brands to have thoughtful, genuine messages. And most importantly, there is now a focus on values. With climate-themed protests, and environmental, social, and governance (ESG) issues becoming mainstream, and a diverse generation that cares more about these matters, brands need to behave better and respect the planet, and be more mindful of cultural differences and sensitivities. Younger generations are clearly purpose-driven and expecting the companies they buy from to start 'getting woke'.

LOCAL CLIENTELE

Apart from these three consumer segments that will likely continue to drive growth for the next decade, the magnitude of the rebound in terms of luxury sales over the past year can also be attributed to a counter-intuitive buoyancy of local clientele, notably in the United States.

A combination of strong equity markets, a lively secondary home market, stimulus packages, and the benefits of 'staycationing' has caused consumers to spend a lot more on luxury items as they cut back on trips, fancy hotels, and restaurants, so that they end up having greater means to spend on 'stuff'. The Biden campaign's 'K-shape' recovery rhetoric from late 2019 has begun materialising in the real economy: those who struggled pre-Covid are struggling more now unfortunately; those who were well-off pre-Covid have even greater means today. The U.S. has often been regarded as an emerging market for luxury goods. It finally appears to be catching up. If wealth were the sole deciding factor, the U.S. would already be a more significant market for luxury. Yet, after 9/11 and the 2008 Global Financial Crisis, it appears that American consumers held back on luxury purchases. One reading is that Americans may have lost confidence, given how the world had developed;[2] another reading is they may have seen such behaviour as inappropriate or even vulgar. However, I observed that this so-called 'guilt factor' has evaporated somewhat with a notably younger and more diverse American clientele engaged in what some have called a 'survival trade', i.e., "I have survived this period of stress, so it's okay to reward myself".

Outside of the U.S., the luxury purchases of local clientele in Europe too have rebounded with a magnitude that was also difficult to anticipate. Part of the explanation is that consumers likely have greater means, having been stuck at home for so long. Yet, the success of some brands with local European clientele for the past 12 months can also be clearly attributed to the fact that sales associates in Europe, who might have been relying on Chinese, Korean, Japanese, American, or Russian tourists, have finally started to zero in on locals anew, having seen a growing interest from them. Maybe they had been ignored for too long, and appreciated the renewed engagement. This is a healthy development, as many brands had become complacent, relying excessively on tourists and not leveraging the clientele base they had in their own markets. It also shows that while the future of the luxury market will be largely influenced by Chinese consumers, there are many other nationalities that can still be tapped on, even those markets that you thought were mature or saturated.

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Impetus from scale, and mergers and acquisitions

Scale and M&A are key themes in a post-Covid luxury world, and the speed of change has been no less than overwhelming. In an era dominated by a 'buy less, buy better' attitude, leading brands in the industry, such as Louis Vuitton (handbags), Cartier (jewellery), and Rolex (watches), have dramatically increased their leadership. Separately, as the post-Covid rebound has been fuelled by the important contribution of first-time purchasers, it is clear that they want to buy essentially the most iconic brands in the space, and within those, the most iconic ranges–the so-called 'signature' or 'hero' products.

Scale in the luxury sector confers VAST advantages related to *Voice, Authority, Synergies, and Talent*, so it is no wonder that the major players will strive to grow even bigger. M&A is a function of the benefits of scale and will be influenced by increased cash on hand, the importance of hedging, and personnel dynamics. Over the past six months alone, there has been a multiplication of deals being announced in the luxury sector. Moncler has bought Stone Island, Exor has taken stakes in Christian Louboutin and Chinese luxury brand Shang Xia, Zegna has listed via a SPAC (Special Purpose Acquisition Company), and Cartier-owner Richemont has taken over the high-end leather goods brand, Delvaux. More notably, market leader LVMH has gone after other opportunities by taking a stake in rosé wine producer Chateau D'Esclans, Jay-Z's Champagne and Virgil Abloh's Off-White venture, and has also raised its stake in the Tod's Group. LVMH should remain the main luxury aggregator, but you can expect other groups to contribute to the industry consolidation as well. No one is a forced seller in the luxury market, but in a period when valuation multiples are still high and money remains cheap, sellers may want to start looking at their options.

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The future of physical stores

While the world has gone online during the Covid-19 crisis, e-commerce has its limitations as a contributor to luxury brand sales. Unlike Nespresso capsules, cosmetics, or Nike footwear, luxury items are highly prized, so purchasing them for the first time via online channels might be counter-intuitive for many consumers. Separately, many luxury brands might aspire to eventually control their distribution as strictly as Louis Vuitton does, meaning that third party, wholesale websites could come under pressure.

I am a firm believer that brick-and-mortar is still the future of luxury. But you will need to give consumers a good reason to get up from their sofas, leave their homes, go out, and browse products in a physical store. As long as your main aim is not just to sell, you should do well as a brand by offering consumers a unique experience and a place to spend time and socialise, learn, and be entertained. This requires managers to change the way they consider their network and how they measure success, moving from like-for-like metrics to a measure of 'net promoter score' or NPS, which quantifies the difference between the percentage of consumers who have positive impressions versus the percentage of those with negative ones. As such, it is an indication of whether consumers will recommend your brand to their peers or advise them not to visit your stores. In other words, the store is not the key vehicle to sell; rather, it is the key vehicle to influence, build memories and emotions, and attract people to come back. This puts tremendous pressure on brands to get up to speed. While managers attempt to figure out what their network eventually needs to look like, pop-up stores are a good means to try out some new concepts and test the water to address new consumer aspirations.

As luxury moves from being a recruitment to a repeat purchase business over time, there will be the potential for substitutes to arise.

What is in store for the medium term

Some doubts have started to creep in following a very strong rebound of sales in the sector since the summer of 2020. For instance, there are doubts about whether the U.S. and China rebounds can last. It is true that the surge in sales in the U.S. has been dumbfounding and many brands seem to have been taken by surprise. What goes up must come down, right? I am not so sure. This is because first-time purchasers might come back and more importantly, influence others to purchase luxury items for the first time, accelerating the thought that these types of purchases are completely socially acceptable.

In Mainland China, fear revolves around the 'common prosperity' messaging from the authorities, which are aiming for a more balanced distribution of wealth. On paper, that would mean curbs on very wealthy individuals, though they are unlikely to be the key contributors to sales at Louis Vuitton and others as Chinese luxury consumption is essentially fuelled by middle-class consumers rather than high net worth individuals. In reality, it is likely to translate into a further acceleration of the middle-class expansion as the authorities look to redistribute wealth, which is unlikely a negative.

Another fear is that, as the luxury market moves from first-time purchasers to repeat purchasers, there may be substitutes emerging: affordable luxury, travel, hospitality, and many other subsectors offering premium products or experiences. In theory, affordable luxury should have great growth potential as brands in the sector tap into the quick expansion of middle-class clientele. In practice, at least for the key handbag and accessories segment, growth is likely to be difficult as consumers would rather wait to save up for premium European brands that carry a higher return on their investment. In theory, travel might also be a threat to luxury. Indeed, as 'staycationing' has enabled consumers to save up and purchase products, theoretically, as the world opens up, this could reverse and luxury could suffer. I use the word 'theoretically', because even though long-haul travel has not picked up much yet, domestic travel in both the U.S. and Mainland China has rebounded dramatically, and there has been no real impact so far on the luxury sales momentum in both markets. It seems that for wealthy individuals, spending on luxury items, or trips, hotels, and Michelin-starred restaurants is not an either-or choice.

Sustainability should be the most disruptive trend of the next decade. Ethical transparency, production traceability, and environmental sustainability are not mere buzzwords for the young generation. It is the biggest threat for the sector. If tackled well, it could become a huge opportunity for the sector and enable it to stand out.

Whether it is lab-grown diamonds, faux fur, or second-hand apparel, the next decade will be very disruptive for a sector that had arguably become complacent while enjoying a decade of strong growth. Existing luxury companies need to have alternatives such as these emerging categories in mind, and possibly invest in them as a hedge for when they affect their current businesses. A genuine transformation of processes is needed, as the next generation of consumers will not be so gullible. They will be asking questions.

A substantial amount of growth potential remains to be harnessed. The question is whether the industry will be brave enough to self-disrupt. Sometimes change only comes when managers don't have a choice. In 2020, a common joke was, "Who took care of your digital transformation? Your CTO? Your CEO? No, Covid-19!" External shocks can hold a silver lining–as long as brands remember whom they are selling to. Events like the pandemic can be catalysts for change that has long been needed, so that companies do not become irrelevant. The next decade will be positively influenced by the sector's shift from complacency.

This article is based on the author's latest book "Future Luxe: What's Ahead for the Business of Luxury", Figure 1 Publishing, 2020.

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