BUSINESS OF LUXURY

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VIDEO on FT.com
Lionel Barber, **Martin Wolf** and **Vanessa Friedman** interview leading figures at the FT luxury summit in Monte Carlo **FT.com/luxury-video**

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Slimming all the rage as belts tighten

Haig Simonian investigates the problems faced by luxury goods conglomerates in the current market

For years, equity analysts urged Johann Rupert to spin off tobacco and turn Richemont, the company he chairs and controls, into a "pure play" luxury goods group. In 2008, the independently-minded Mr Rupert finally took heed and returned Richemont's stake in British American Tobacco to shareholders, leaving his group focused on Cartier jewellery, Montblanc pens and much else.

Today, some of the same pundits are regretting the loss of those high and stable BAT dividends, as the world's luxury goods industry struggles with its biggest challenges in decades. Demand has tumbled virtually across the globe with no clear sign of recovery. Manufacturers from LVMH Möet Hennessy Louis Vuitton, the world's biggest luxury goods group, to Italy's Bulgari, find themselves saddled with stubbornly high costs, leaving little room for manoeuvre. Even beauty has proved vulnerable, contrary to the common claim, as figures for L'Oréal and others show.

On top of the market problems, the sector faces tough secular change. Globalisation has put a premium on size – but sheer mass risks diluting the exclusivity that is luxury groups' key feature. The grim economic backdrop has also come just as some companies, notably in leather goods and fashion, face anxieties about ethics and environmentalism. Advocates of sustainability have targeted groups using rare species and skins; parfumiers have to cater to growing interest in all things organic.

Ever fickle, luxury goods have turned near impossible to predict – as the irony of Richemont's restructuring demonstrates. So hard has it become to forecast the market that many top manufacturers have virtually given up. "Visibility is non-existent" says Norbert Platt, Richemont's chief executive.

The unpropitious circumstances have been reflected in grim results. Bulgari has incurred its first quarterly loss in 10 years. Burberry, the UK fashion brand familiar for its distinctive plaid, last month reported its first full year loss. Richemont's sales in April, the first month of its new financial year, were down 19 per cent. Tiffany's first-quarter sales and profits tumbled as expected. And last month, Christian Lacroix, one of the biggest names in French fashion, filed for protection from creditors.

With the scope for cost-cutting limited, brands have turned to "cost containment". Hiring has stopped, temporary labour contracts have been suspended and pay sometimes frozen. Store networks, particularly in the stricken US, have been pruned.

Richemont is closing 62 outlets, mainly in the US, while Burberry has taken heavy charges on the value of its Spanish stores. And everyone is looking to protect cash flow by reducing inventories and squeezing suppliers.

In an image-driven business, only marketing and advertising have escaped relatively unharmed, as manufacturers fear tarnishing their brands. Reducing share of voice risks inflicting permanent damage in an industry where customer perceptions are vital. Manufacturing has also been protected – as far as possible – with fashion and watchmaking brands especially aware of the difficulties of replacing highly-trained seamstresses or watchmakers when the upturn comes.

How severely companies have reacted has depended on market factors and on owners' perceptions of the crisis, in an industry still dominated by individuals.

Richemont's Mr Rupert has been among the hawks, warning of the sharpest downturn in 20 years. Francesco Trapani, chief executive of Bulgari, by contrast, said last month his group had registered a "clear sign of improvement" in April, both at its directly-operated stores and even in the tougher third-party distribution channel. Burberry's Angela Ahrendts reinforced that message, noting recently that the recession was beginning to diminish. And Nicolas and Nick Hayek, the father and son team at Swatch Group, maintain the second half will bring a distinct improvement. More objectively, Bain & Co, the management consultancy, believes the luxury goods market will shrink by 10 per cent this year, with the pain concentrated in the first half, following a flat 2008.

But some broader themes have emerged. Take geography. Those brands particularly exposed to the US have faced the biggest challenge, with Japan not far

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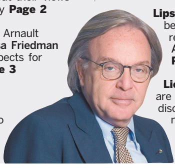

Big squeeze: slow sales, hiring freezes and store closures have made it a tough year for the sector Lynch

How the world economy might recover its poise

ECONOMICS

Martin Wolf talks to three economists about the prospects for a global recovery

The world is in the midst of the worst financial crisis and biggest global recession since the 1930s. But many now see reasons for hope. Is this plausible? Where will the recovery come from?

Stephen King, HSBC Group's chief economist, Jim O'Neil, head of global economic research at Goldman Sachs, and Norbert Walter, chief economist of Deutsche Bank Group, give their answers to these vital questions below.

Go east: domestic demand in China is the world economy's best hope for a recovery and where the best opportunities for luxury retail are to be found Getty

Are the "green shoots" real or imaginary?

SK: In contrast to the suffocating fear of depression at the end of 2008, financial markets have staged a recovery and aggressive de-stocking is drawing to a close, which suggests a pick-up in industrial production is due.

Yet worries remain. Final demand is depressed. Traditional monetary policy has run out of room and fiscal policy will do so soon. Economic recovery depends on "unconventional monetary measures", which are mostly untested. Deflation is a risk.

Recovery will be a struggle. High levels of debt will constrain the pace of activity, at least in the developed world. The good news comes from elsewhere: Beijing's policymakers have shown they can kickstart Chinese domestic demand, offering a silver lining to a mostly recessionary cloud.

JO'N: According to our proprietary indicators, as well as much recent published leading and coincident indicators, the shoots are blossoming into daffodils. Our global leading indicator has shown a marked improvement in the past two months after dramatic falls from October through February. We are confident that by the third quarter world economic growth will be positive again.

The strongest positive signals are coming from the largest developing countries, especially China. Within the so-called "advanced countries" the shoots seem greenest in the UK, perhaps surprisingly. In addition to a strong recovery in business surveys, consumer spending appears to have held up much better there than many pessimists expected.

NW: The green shoots are real. This is because the precipitous drop in orders and production after the third quarter of 2008 corrected excessive stocks of almost everything. Since one can run down stocks only once, a continuation of the free-fall seen in the last quarter of 2008 and the first quarter of 2009 was impossible.

If observers consider such an inflection point to be the start of a genuine recovery, they are dead wrong. The stock market correction may be a false dawn, as well. But since yields on alternative investments are so low, increasing the weight of equities in portfolios is reasonable.

Which parts of the world economy are going to recover first and which will lag behind?

SK: China is already in the lead. While its exporters have suffered heavy losses, the government's domestic infrastructure policies appear to be bearing fruit.

Yet an infrastructure-led pick-up in Chinese domestic demand will do little to help other Asian exporting nations. The world's commodity producers – the Middle East, Russia and parts of Latin America – should, however, benefit from China's insatiable demand for raw materials.

History suggests the US will recover more quickly than Europe, although its ongoing housing market weakness is a new experience. The biggest risk for the eurozone is the euro's likely strength, as investors conclude that Frankfurt's central bankers are less keen on the printing press than those of the US and UK.

JO'N: As each month of 2009 passes, we find ourselves thinking ever more that this crisis is almost good for China, or more specifically, for China's role in the world economy. China seems to realise that an export-based model of growth is no longer sustainable.

'As each month of 2009 passes, we find ourselves thinking ever more that this crisis is almost good for China'

In addition to the big stimulus package, China has embarked on a big reform of social security. By pressuring its banks, as well as cutting interest rates and reserve requirements, Chinese financial conditions have also dramatically improved. We recently made a positive revision to our forecasts for Chinese growth in 2009 and 2010. We now forecast 8.3 per cent and 10.9 per cent, respectively.

We have also revised upwards our forecasts for Hong Kong, Taiwan and Korea and become slightly less pessimistic for Japan. We now forecast 3.2 per cent world GDP growth in 2010 after a 1 per cent decline this year. Meanwhile we see the "old economies" of Europe and Japan lagging behind.

NW: If one does not need parliamentary approval for anti-cyclical measures and citizens have little right to intervene in government planning and execution of projects, investment spending can be faster and more effective. So China will lead in propelling domestic demand.

Effective measures for stimulating demand for passenger cars in a few countries may also see these industries recover in 2009. Countries with excesses in real estate and construction and those with a concentration in the financial industries will be hit harder and for longer.

What needs to be done to ensure a durable global recovery?

SK: While policy-makers have helped avoid a "Great Depression Mark 2", their work is not yet over. The crisis has revealed many fault-lines within global finance, including the mismatch between a global capital market and national regulation and supervision. It is hard to imagine a return to the "status quo ante", yet the shape of any future financial architecture is, at best, hazy. My guess is that there will be significant diminution of cross-border capital flows.

Unconventional policies will have to be maintained for many quarters. I am also not convinced we have seen the full effect of toxic assets. I very much doubt that the banks alone are threatened by the problems of toxicity.

Meanwhile, the attempts to rescue the financial system have extracted a heavy fiscal cost, notably in the US and UK.

JO'N: We are optimistic about prospects in the "BRICs" (Brazil, Russia, India and China). We also see scope for an inventory-based recovery in the group of seven high-income countries for a few quarters.

Yet a more sustained global recovery will probably need the world to cope with a further reduction in the importance of the US consumer. In order for the world to avoid many years of subdued growth, we need stronger demand in the older economies of Europe and Japan. This will require bolder policies, aimed at reducing household savings in Germany, and corporate savings in Japan.

For the US and UK, export growth is likely to be the source of sustainable strength, but without stronger demand outside their borders, this will be slow to develop.

In all, we appear to be entering a period where the relative share of incremental activity will be even more dominated by the BRICs than in the "noughties", especially by China and India. For luxury retail companies, this is where the big opportunities remain.

NW: First, the trends of 2003 to 2007 were unsustainable. The irresponsible monetary policies, lack of regulatory discipline over financial markets, depletion of resources and growing burden on the environment cannot continue.

Second, the huge government involvement may lead to excessive intervention in markets, including the risk of protectionism. Regional and global co-operation should be the goals. President Obama should lead. Europe should follow. The Doha round ought to be revived. This financial crisis and its ensuing rescue packages must not threaten the globalised system, which is so beneficial to mankind and particularly the emerging world.

In sum, the three agree the world economy is starting to improve, but many obstacles stand in the way of sustained and vibrant economic growth.

Luxury marketing plays by a different set of rules

Guest Column

JEAN-NOEL KAPFERER and VINCENT BASTIEN

The present economic crisis has forced all companies to question their strategies and practices, and this has never been more crucial than for luxury brands and marketing.

What once worked as a means to sell products no longer works; it is time to reconsider the essence of luxury management.

As faculty at the HEC School of Management in Paris, it has been our job to analyse current practices, and it is our conclusion that the most striking feature of contemporary luxury management is the necessity to turn marketing on its head: classical marketing is the surest way to fail in the luxury business.

Instead of the marketing status quo we have proposed the "anti-laws of marketing": 18 axioms that include: raise your prices to increase demand; advertising does not aim at selling; and – most importantly – do not pander to consumers' wishes.

At a time of managerial consensus on the necessity to focus on the client, this might seem like heresy. And, for most brands and goods it would be. But not for luxury. The reason for this can be traced to the birth of the luxury goods business, two centuries ago: while the craftsman – or expert artisan – would go to Court and make the cloth or furniture his aristocratic client had in mind, the luxury goods business as we know it did not exist: the artisan was merely a supplier of bespoke products.

It was not until that artisan started creating objects the clients had not yet thought of that luxury became a distinct market.

This inverted the client-creator power structure: consumers started queuing to discover something new.

But does a guide for the tastes of the future start by interviewing prospective clients? Or by developing a personal vision, realising it, and educating elite clients who become role models? Consider the cases of fragrances and cars.

The doyenne of classic marketing, Procter & Gamble, has a Beauty and Prestige division for its licensed fragrance business where it applies the same rules as for its FMCG (fast moving consumer goods) brands.

Everything begins with market research aiming to identify specific consumer segments and their needs. The goal is to launch a product for each segment in order to build the brand's portfolio of fragrances, but the problem is that the consumer expectations are often very much the same across brands.

Hugo Boss and Lacoste are two P&G licences, for example, that share the values of panache, youth, class, success and energy; they share a consumer base and thus the launch advertisements for the two brands are almost interchangeable.

This consumer-centric approach also produces a built-in obsolescence: its products do not last because they are based on transient consumer needs and stereotypes. The scent must have immediate appeal to maximise the chance of success: P&G takes no risks and uses the fragrances rated high in the trends.

But olfactive preferences are short-lived, and this fragrance building model leads to short-term success.

Fragrance licences grow sales by launching new products, year after year: but the older ones cannot sustain sales generated by the massive marketing investment at launch. To

A consumer-centric approach produces its own built-in obsolescence

Jean-Noel Kapferer (left) and Vincent Bastien

be profitable they need to reduce such investment but without a big marketing push, product demand often falters.

Luxury brands today are the trailblazers of tomorrow's taste.

Once a consumer segment is identified it is too late to exploit it.

There is no surprise in existing demand. This is why all classic luxury scents – many still in the world top 10 of fragrances – were created through emotional intuition, from Yves Saint Laurent's Opium, Thierry Mugler's Angel, Jean-Paul Gaultier's Le Male, and, of course, Coco Chanel's N° 5.

Let us now compare the fate of Saab and Mini. Mini (bought by BMW with Rover in 1994) sold 250,000 cars in 2008; Saab (bought by General Motors in 2000) sold 93,000, and it is now bankrupt, despite the fact that its latest Saab 9-3 was seen as one the best cars in its category.

To boost the sales of Saab, GM took a classic marketing approach, asking consumers what they did not like about former models. As a result, they softened the radical design and used an Opel engine. The resulting Saab 9-3 looked more like rival products from Audi or BMW than a traditional Saab.

By contrast, BMW has retained many of the Mini's historical characteristics despite consumer surveys repeatedly labelling them as faults: too small a boot, too low a car – but these quirks were integral to the unique kart design and style experience of the 1960s that made the car popular in the first place.

Of course, luxury companies should not ignore their core customers' wishes entirely, but too much listening mitigates against the requirements to surprise and stand apart.

As a cultural creator, luxury brands should set their own high standards.

Listening to the consumer is the best route to a lack of differentiation, and failure to inspire the dream – the two levers of desire that are the only paths out of the recession in the luxury world.

Jean-Noel Kapferer and Vincent Bastien are co-authors of 'Luxury Strategy – Break the Rules of Marketing to Build Luxury Brands'

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How to manage the transition into quality

INTERVIEW
BERNARD ARNAULT

Vanessa Friedman discusses the state of the industry with the head of LVMH

Bernard Arnault, chairman of Möet Hennessy Louis Vuitton, the largest luxury company in the world, does not like the word "luxury".

"I prefer to think of it as quality," he says, a caveat that may seem semantic, but is, in fact, significant: it speaks to the permanent change in the industry that he sees occurring post-recession.

"The availability of money not just for consumers but buyers will disappear for a very long time – maybe 10 years, maybe until the next bubble," says Mr Arnault, who believes sector growth will be driven by the real economy, and will not be much more than 2 per cent a year in developed markets – half the rate of the past. What this means for the luxury industry is more competition, not from more brands, but from a – permanently – more discerning consumer base: one that demands legitimacy in all its goods, from history to conception to manufacturing, along with all the information and communication that implies.

And what that means, as far as Mr Arnault is concerned, is placing ever more importance on sustainability, not just in ecological terms (though that plays a part), but in corporate strategy.

"It is a natural tendency of companies during a crisis such as the one we are in to cut costs, drop prices, and stop expanding, because it has the most immediate impact on numbers," he says. "But what we have learned in the many crises we have been through is that this is a mistake, especially when it comes to luxury.

"Last winter, when I was visiting one of my Vuitton shops, a number of customers actually came up to me and thanked me for never putting any products on sale," he continues. This was around the time US department stores panicked at the prospect of a negative holiday season, and slashed prices up to 60 per cent pre-Christmas; because Vuitton has a policy of never discounting products, and has no wholesale distribution, they were not subject to the sell-off.

'If you don't put your products on sale consumers feel they are buying something that retains its value'

"If you don't put your products on sale consumers feel they are buying something that retains its value," continues Mr Arnault, and value is one of the catchwords he sees for the future. After all, if worth is long-term, consumers are more likely to invest, even if the vehicle is a handbag.

Though Mr Arnault acknowledges the current global recession is a magnitude greater from the others he has experienced since he first began creating the world's biggest luxury group in 1985, he also believes the lessons he learned in the early 1990s and post 9/11 and SARS helped position his group to be able to withstand the downturn. Ten years ago, for example, the company took a position on the need to pay down debt with an eye to the long-term. Indeed, when it comes to luxury, Mr Arnault says it is important not to have a three year plan or even a five year plan, but a generation plan – a generation being the amount of time he believes it takes to give a luxury brand the historic component that is necessary to confer "legitimacy".

Thus, despite much speculation about his desire to add to his luxury portfolio with a leading company such as Giorgio Armani or Hermès, Mr Arnault has been on a relative spending hiatus since the turn of the century, divesting himself of such loss-making brands as Christian Lacroix in 2005, and making only smaller, strategic investments, such as Hublot last August, which, with its growth in Asia, was seen as strengthening the relatively small LVMH watch business; and last month taking a minority share in Edun, the organic clothing line developed by Bono and his wife Ali Hewson, which will allow LVMH to improve its green credentials, perhaps extending the ethical edge to collaborations with other brands within his group.

More than just a pretty dress: Marc Jacobs' autumn-winter collection for Louis Vuitton AFP

"At some point in the last cycle, everyone lost their common sense and did crazy things, in luxury as well as in housing," says Mr Arnault, making reference to the sudden trend of private equity buying into luxury. "It was very easy to get lots of money to invest, but that is over."

Still, Mr Arnault says he is already seeing – if not green shoots, then brown and beige LV-branded sprouts, especially in the US, the area Mr Arnault believes will rebound first, possibly as soon as this winter.

Mr Arnault believes that the combination of government investment, reactive companies, and his refusal to change course in the face of the current market crisis will create a positive environment for his many brands, including Christian Dior, Givenchy, Fendi and Celine, though especially the flagship Louis Vuitton.

The luxury landscape will obviously look very different on the other side of global recession, however. Already, Mr Arnault believes, a number of trends are identifiable that will gain momentum as the luxury industry – and, indeed, all industries – begin to see the light at the end of the tunnel. Chief among these are the insistence on "value and values" on the part of the consumer; the emphasis on control on the part of brand managers that is bestowed by own-retail as opposed to wholesale models – though that clearly implies yet more investment; and the importance of the internet, for both good and ill.

"The internet is more and more important for both communication and how we manage our company internally," he says. "I can have instant access in real time to my stores around the world. Then there's the fact that more young people are almost uniquely receiving information on the internet, and the fact that we feel it is a customer service to sell products online. But at the same time, it is the greatest risk to this industry going forward."

The proliferation of fake products sold on the internet is, Mr Arnault believes, the single biggest danger to the luxury industry post-recession, since it undermines its evolution from a sector based on "luxury", with the bling that suggests, to one based on quality.

"To me this is the thing we have to tackle next," he says.

"We have to find some way to put morality online. After all, it is one of the fast-growing areas of tomorrow's economy."

Slimming all the rage, belts tighten

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behind. Europe has been mixed, while Asia, notably China, has remained resilient. Bain expects only China and the Middle East to escape this year's contraction.

Robust Asian markets have tended to favour the larger groups, such as LVMH or PPR, owner of Gucci, with the broadest international networks and the resources to have invested heavily there. "In the current context, we see emerging markets exposure to be the key factor limiting adverse trends in more mature markets," notes Luca Solca, luxury analyst at Sanford Bernstein.

Products are the second key factor. Firm data is scarce, but many analysts argue that, in hard times for even the rich, cheaper items, such as shoes or handbags, hold up better than pricier ones. "Gift giving will still go on in the sub $1,000 bracket, but not with watches costing $50,000 or more," says Jon Cox, analyst at Kepler Capital Markets in Zurich.

The breadth of a group's range also matters. Here, the evidence is not compelling – as the relative health of Hermès shows. But most analysts say companies with products spanning price points are more protected than those, like the French silk and leatherware group, that are more tightly focused. A broader portfolio means manufacturers can cater to consumers trading down, and can provide muscle with third-party wholesalers and retailers.

In a market where prominence has become more pertinent than ever, distribution has gained ground. Independent retailers, facing stretched credit lines, have destocked rapidly to preserve cash flow. Luxury goods brands, such as Italy's Luxottica, with a high proportion of directly operated stores, have enjoyed greater protection than those dependent on third parties. "We continue to see risks associated with a high exposure to the wholesale network – channels must destock before a recovery in sales can occur," notes Louise Singlehurst of Morgan Stanley.

Sheer size has become a great differentiator. "The strong brands are getting stronger and the not-so-strong brands are getting weaker," says Mr Platt.

Having a portfolio of products, such as at LVMH, Richemont or PPR, has helped to spread risk. While financial flexibility may be more dependent on gearing than size, bigger groups can spread costs over much larger turnovers, enjoy greater potential for cost synergies, and more sway over suppliers.

With centralised treasury operations, the largest groups may also be better placed to withstand currency swings. And they may have deeper and better qualified management pools. Recent upheavals at Italy's Versace have spotlighted the potential for internal squabbling when times get tough.

Finally, the largest groups may be best placed to exploit opportunities from the tougher market. That means anything from negotiating better product positioning in stores to improved terms from media outlets or rental contracts from mall owners.

Ultimately, the biggest groups may also seize any rare chances for acquisitions in a still-fragmented industry. Richemont's Mr Rupert has said none of the companies he covets is for sale. But he – and others – have taken care to avoid mistakes of the previous downturn after 2001 by ensuring strong balance sheets. That not only reassures shareholders, but also provides the financial firepower to act should the chance arise.

Italian atmosphere is central to Tod's global expansion

INTERVIEW
DIEGO DELLA VALLE

Vincent Boland talks to the head of the Italian fashion house about quality and globalisation

It is not too difficult, in the high-ceilinged elegance of Palazzo Della Valle on the Corso Venezia in Milan, to be seduced by the charms of a certain kind of Italian lifestyle. Here is the headquarters of Tod's Group, which has become a powerhouse in the marketing of that vision to the world's wealthy and discerning.

The atmosphere is deliberate: where some Italian fashion houses have expanded ever further into the realms of celebrity and glamour, Tod's is anchored as firmly as it can be to its family roots and its traditional, hand-made, century-old heritage.

Its signature products – shoes and bags – are made of leather, a raw material that has remained almost unchanged since it was first discovered. A new advertising campaign will take the company back to basics, with a focus on Italian families and their lifestyles – actual Italian families, however rich and privileged – rather than on celebrities.

"The Italian lifestyle is in our DNA, and in our group we believe in our DNA," says Diego Della Valle, the chairman and chief executive of Tod's Group.

Dressed in a blue blazer and jeans and comfortable-looking shoes, he looks younger than his 55 years and betrays only a hint of jetlag despite having just returned from China. He is the grandson of the founder of Tod's, and he refers on several occasions during the course of a nearly hour-long interview to the DNA of his company, by which he means precisely that artisanal heritage that is synonymous with the Italian concept of luxury and, one might say, with the Italian concept of family.

"You can see the true vision of Tod's through Italian families," Mr Della Valle says. "These are people who live privileged but also serious lives; real people, not actors or models."

This image is especially important in new markets, such as China and India, he says. In common with other luxury goods makers he is intent on capturing consumers in those markets who aspire to the same sense of the Italian lifestyle as do customers in more mature markets. "They have an extraordinary sense of what luxury is, and they aspire 100 per cent to the same sorts of things that others do," he says.

> You can see the true vision of Tod's through Italian families . . . who live privileged but also serious lives

It is an expensive business preserving that DNA in an increasingly homogenised global market. Mr Della Valle says it is essential that companies such as his have full control over their image, production systems, and marketing.

The downturn is testing all brands. It is also challenging the "Made in Italy" segment of the Italian economy, with wholesale producers complaining of vanishing margins and profits.

"A luxury goods company has to have control of its image," he says. "For Tod's, the thing is to communicate this tradition, the generations of work that have gone into our products. For us it's an absolute priority."

To achieve it, one must put quality before quantity, and one must maintain the group's traditions even as it globalises, which it has been doing fairly relentlessly in the past decade.

Apart from Tod's hand-made shoes, coats, and bags, it also produces more casual shoes and clothes for its Hogan and Fay brands. In 2008 the group had revenues of €708m and net income of €83m, and, while the Della Valle family has majority ownership and full control, it is quoted on the Milan stock market, where it is worth about €1.2bn.

The challenge is to marry tradition with modernity in a way that not all Italian luxury goods and fashion producers have managed. Tod's has done it, Mr Della Valle says, by maintaining one key vision: "We're a luxury goods company, not a fashion company."

This distinction between fashion and luxury is central to Mr Della Valle's global ambitions. The two have different products and ought to have different strategies, he says. The competitors he admires most, he says, are Louis Vuitton, Hermès and Chanel.

"Is Tod's vision modern? I think, very," he says. And do luxury goods companies and fashion companies have the same customers? "Maybe 50 per cent."

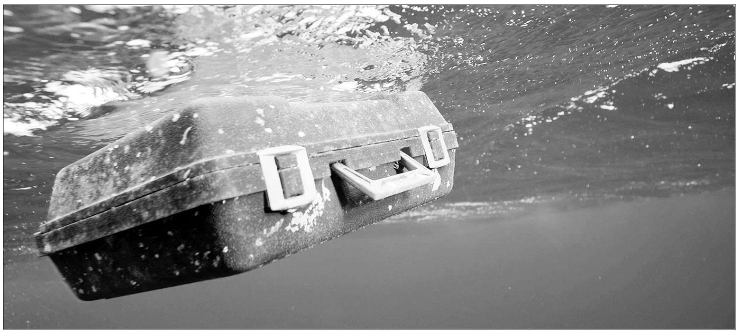
Mr Della Valle says that the goal in the next five years is "to complete the globalisation" of Tod's, for which he has been laying the groundwork. "I'd like Tod's to be much bigger than it is now, without diluting the brand," he says.

He expects China and India to account for as much as 25 per cent of revenues by then, because the growth potential is much higher than in more traditional markets.

"There is a much bigger appetite for luxury goods in those markets than in mature markets, and day by day more people are coming into this market."

But as for China as a competing producer, Mr Della Valle is sceptical about its ability to produce luxury goods.

"It lacks the structure of small companies, the tradition, the concept of excellence" that Italian luxury goods producers have inherited and which they must maintain as a competitive advantage, he says. "Made in Italy doesn't necessarily mean expensive goods," he says. "It means excellent goods."



Travelling light: a suitcase bobs around in the Pacific along with thousands of tonnes of packaging and other waste Greenpeace

Build for a lifetime and it won't end up on the dump

ENVIRONMENT

Fiona Harvey asks what approach the industry should take towards waste

The Great Pacific Garbage Patch is a vast area of sea north-west of Hawaii, estimated at about seven times the size of Ireland, containing billions of pieces of plastic detritus.

The floating rubbish dump is the result of the winds and currents of the oceans carrying away the mess from our throwaway society – though most of the plastic packaging, bags, nappies, fishing nets, toys, bits of equipment and disposable trinkets of various kinds that we dump is left in landfills, some of it finds its way to the sea.

Much of the rubbish bobs around coastal waters or is washed up ashore, but the remainder can be carried long distances, and the Garbage Patch is where several significant ocean currents and winds converge.

The plastic, much of it broken into small pieces, is a danger to marine and bird life. Fish and birds mistake the small pieces for food, and cannot digest them, either choking or starving as a result. Or they get caught up in the longer strands and die.

David de Rothschild, a scion of the banking family, is an adventurer turned eco-warrior, whose latest project is to make a boat from plastic bottles and recycled waste. He is sailing the boat – the Plastiki, in a pun on the famous Thor Heyerdahl craft – to the garbage patch to highlight the toxic threat it poses, and the damage that our throwaway habits are doing to the oceans.

The boat and journey are being sponsored by IWC Schaffhausen, the high-end watch company. Mr de Rothscild argues that there is something in the very nature of a long-standing luxury brand that chimes with the values he is trying to reinforce by his voyage, including that seeing consumer goods as inherently disposable is a waste of resources. "IWC is a brand that seems to continually attract a loyal, long-term and – most importantly – passionate customer, who is generally very often obsessed by the brand and everything it stands for," he says.

The idea of luxury goods is that they are built beautifully and built to last. This is the very antithesis of the ideas behind the throwaway society that have led to the creation of the vast mess of floating detritus the Plastiki plans to chart.

Luxury goods companies are picking up on the fact that their products can offer consumers a way to consume economically – if not in cash terms, in environmental terms – by buying a product that will last for many years rather than a disposable mass-produced imitation that will end up in the dump.

Some watch companies, such as Patek Philippe, have for some time deliberately marketed their products as heirlooms in the making – they are to be passed on through generations. Jewellery companies take the same line – a diamond is, after all, forever.

This is, in some senses, the ultimate in recycling and in the economy of the use of resources which environmentalists preach.

"Durability does make these products more environmentally sustainable – the fact that they can be used for a long time is good," says Anthony Kleanthous, senior policy adviser to WWF, the green campaigning group.

He says that making goods that not only have a value in themselves, but also have a value at re-sale, can mean that products go on to have lives with other consumers once their owners have tired of them. This is a message that resonates with the environmental values of thrift and the green mantra of "reduce, reuse and recycle" – to "reduce" consumption, reuse "products" and "recycle" when products have reached the end of their useful lives.

> 'If someone just buys 10 of these [luxury goods] and puts them in a drawer, how is that good for the environment?'

These three values are presented in that order because reducing consumption of resources, and of waste, is the best option, followed by reuse which is also green, and recycling is a last resort.

Luxury goods owners buy into this idea. Watch enthusiast George MacDonald says his favourite possession is a Jaeger-LeCoultre Reverso watch, with a face that flips over to protect the glass while playing polo, which he has owned since 1999. "It will last me forever," he says. A problem arises, however, when high-end consumers use their wealth not just to buy the best, but to buy far more than they need. "If someone just buys 10 of these [luxury goods] and puts them in a drawer, how is that good for the environment?" asks Mr Kleanthous.

So campaigners would prefer consumers to be conscious that it is good to buy durable items, within their budgets, but not to over-consume. They also urge luxury goods owners to donate their items to second-hand ownership once they have finished with them, and only to recycle them if absolutely necessary.

Mr Kleanthous also warns that this "built-to-last" ethos does not absolve luxury goods companies from needing to take greater care to protect the environment, he warns. "It depends also on the efficiency of the products, of the waste involved in their production, in the energy required and in where the raw materials come from and how they are used," he explains.

But luxury goods companies have the opportunity to present their products as relevant to the green pattern of consumption – buying a smaller number of higher-quality goods and services – which may become essential if we are to succeed in marrying economic growth with the lower consumption of natural resources. Which could help, in future, to cut the size of the ocean's enormous garbage patch.

Exchange rates blamed for price differences

POWER OF PRICING

Imran Amed examines the effect of currency fluctuations on the industry and consumer behaviour

Last July, reporting LVMH's first-half results, Jean-Jacques Guiony, chief financial officer of LVMH, made a pointed observation: group operating profit increased by only 7 per cent, due to the impact of the biggest currency fluctuations the group had ever seen. At constant exchange rates operating profit would actually have risen 19 per cent.

When asked for his thoughts in January on the outlook for 2009, he remained cautious: "It's difficult to say how things will pan out in 2009 until we know better how things unfold from a currency perspective," he said. "Volatility is at an unprecedented level and making any predictions is highly risky."

Most luxury companies find themselves with the majority of their costs in euros but up to 80 per cent of their revenues in other currencies. In the past, they have protected themselves against fluctuations through the use of hedging but in the current economic climate, things change so quickly that, according to Claudia D'Arpizio, luxury goods expert at Bain & Co in Milan: "While currency hedging is a useful technique, we are also advising our clients to focus on pricing."

Unlike hedging decisions, which originate with a CFO, pricing decisions are made at the brand level.

While brands have always set different prices for different markets, recent currency shifts have opened up wide, unintended differentials in prices for the same product in different markets. This has led to a kind of fashion arbitrage and poses a new management challenge.

In recent years, it was commonplace for British shoppers to jump on aircraft to New York to complete their Christmas shopping with the benefit of a strong pound, but late last year, after the pound fell more than 20 per cent against the euro and more than 25 per cent against the dollar, it was the British who stayed at home, while eurozone and US shoppers descended upon London to snap up bargains, bolstered by heavy discounting on the shop floor.

In December, Eurostar reported a 15 per cent increase in the number of people travelling to London from the continent, many of whom had apparently come with one purpose: to shop. Burberry attributed some of the 20 per cent spike in its third-quarter UK sales to tourist flows from China and Europe.

In response to this mass consumer migration, luxury companies, including Louis Vuitton and Dior, reduced prices in Japan by 7 to 8 per cent late last year, while Chanel, Chloé and Versace reduced their US prices by similar amounts. But even after these adjustments, a study conducted by Luca Solca, luxury analyst at Sanford Bernstein, found that average prices for a basket of Louis Vuitton and Gucci handbags were 30-50 per cent higher in China and Japan than Europe compared with about 15 per cent a year ago. In the US, the same handbags were 20 per cent more expensive than in Europe, compared with 5 per cent a year ago.

> 'Volatility is at an unprecedented level and making any predictions is highly risky'
>
> **Jean Jacques Guiony**
> **Finance director, LVMH**

Furthermore, many brands, including Gucci and Hermès, seem to have maintained artificially low prices in markets such as the UK, apparently to bolster spending by tourists and locals alike.

While these price differentials are a return to the norm in the sense that they reflect historical industry standards, differential pricing is more obvious than ever before.

Aided by information gleaned from frequent international travel, the internet and brands' own e-commerce sites, consumers are starting to question whether differences are justified, particularly in today's value-conscious environment, and especially in mature and expensive markets such as Japan.

Yet for the brands, making strategic changes is not as easy as it sounds. The problem is this: following the age-old fashion cycle, prices for luxury goods are usually set six months or more in advance, creating a lag in the brands' ability to make any changes once prices have been set.

"In particular, those brands who sell through wholesale channels and multi-brand stores have limited flexibility to adapt pricing later," says Mr Solca. "It is at the moment when brands sell a collection at a specific price after the fashion shows and selling campaigns that they effectively take a currency risk."

So while brands with vertically-integrated retail operations, such as Hermès and Louis Vuitton, can be more reactive and change their prices mid-season, others must also consider their wholesale partners, especially if they want to maintain consistent prices within the same geography.

Proposed solutions to the channel conflict issues include developing separate collections or "splitting the assortment so that a big chunk is not comparable across channels," says Ms D'Arpizio. "This would better enable brands to respond to currency fluctuations as well as protect themselves from discounting in the wholesale channel, which is another important pricing issue."

However, she says, brands should not be making pricing decisions with the sole objective of achieving consistency across markets, but should move towards dynamic pricing with in-season price adjustments, right down to the country level.

According to the Sanford Bernstein report, brands with the most sophisticated pricing strategies, such as Louis Vuitton, are "fine-tuning prices by market in the euro area". Burberry creates a global pricing architecture, where individual regions can provide input on final pricing based on benchmarking, while always ensuring that overall margin targets are met in the end.

"By strategically lowering prices in some markets, brands may be able to capture share in a rapidly changing industry context," Ms D'Arpizio says. "Alternatively, they could maintain higher prices elsewhere, which would allow them to reinvest in their brands. Unfortunately, many brands currently lack the information systems to execute this kind of strategy in a scientific way."

Imran Amed is an adviser to the fashion industry and is Editor-in-Chief of Luxury Society

Innovative retail ideas go on the net

ONLINE

Beauty and fashion on the internet is coming of age, says **Elisa Anniss**

In times of war and uncertainty, make-up is considered a female panacea: the one luxury item that stays in demand no matter what happens in the world outside.

Hence the "Lipstick Index", a term coined following an observation made by Estée Lauder chairman Leonard Lauder post-9/11: as the market goes down, lippy sales go up. And yet, according to a Mintel report that came out in April, lipstick's power as a pick-me-up is not holding truethis time. Mintel's survey, in the US, UK and France, found that from a list of cosmetics, lip colour was the item women would be most likely to spend less on, while more was being spent on shampoo and cleansers. Why? It seems the lipstick index has been replaced by the online index.

Consider the recent results of the UK's largest online fashion and beauty retailer asos.com. Its preclose trading update announced sales up 104 per cent to £165m for the 12 months to March 31, 2009. Now international brands are clamouring to access its customer base: Mango, Hackett, Gant and Mini Boden will appear on its site this summer. And from August, kid's, men's and women's accessories and apparel from Gap will further augment asos.com's 800-strong brand offering (which ranges from High Street names to boutique fare such as McQ by Alexander McQueen, Sass and Bide and PPQ).

The site's successes have also wooed senior retail personnel away from British bricks and mortar. "People want to work somewhere where sales are increasing," says chief executive Nick Robertson.

"With matchesfashion.com it surprised us how quickly the site grew into an ever-expanding market," says Tom Chapman, owner of the UK high-end boutique group He notes that the online store has swiftly become the number one womenswear outlet in the company.

"We forecast a contraction of bricks-and-mortar sales in 2009, with 110 per cent growth online," says Mr Chapman. "This growth is coming from new markets and consumers as well as existing bricks and mortar consumers who are purchasing in increasing numbers online, possibly due to their wish not to be seen so overtly as consumers."

Meanwhile, Yoox Group, the Italian online company founded by Federico Marchetti in 2000, finished 2008 with net sales of €101m, marking year-on-year growth of 48 per cent. In recent years the Yoox Group's focus has shifted from being an upscale TK Maxx to becoming an internet luxury goods specialist – the group also operates e-commerce sites targeting the EU, US and Japanese markets on behalf of Italian brands including Marni.com, Emporioarmani.com, Costumenational.com and Emiliopucci.com. In February, Bally.com and Moschino.com joined its stable, and there are plans to collaborate on an additional six online stores by 2010.

Likewise, Theresa, the Munich fashion destination, which launched mytheresa.com in 2006, has also benefited from its relationships with luxury brands and become an online portal: their offering includes Prada and Tod's as well as brands like Lanvin, Jasmine de Milo, and Givenchy and their customer reach extends to the UK, Poland, Romania as well as France, Spain and Italy. As the only independent purveyors of Roger Vivier footwear online, as well as one of the stockists of Jimmy Choo they have seen shoe sales jump 30 per cent in the first quarter of 2009. As for Jimmy Choo's very own website, sales online have shot up 80 per cent year to date, according to chief executive Joshua Schulman.

> '[Online stores] bring us closer to our customers, when pre-crunch they were becoming remote'

"This crisis is doing our industry a service," says Guy Salter, deputy chairman of the luxury organisation Walpole.

"For a long time no one was questioning the way of doing business and when trading was good it was difficult to see opportunities. Now, if you compare the costs of a store roll-out with the cost of extending what you do online, the latter is more cost-effective and one of the long-term benefits is it also brings us closer to our customers, when pre-crunch they were becoming remote."

A recent online retail and travel report by Forrester Research estimates that about 28m consumers – that is one in two UK consumers – shop online, outspending their European and even their US counterparts.

By 2014, Forrester forecasts 37m UK online buyers will spend £56bn online – perhaps partly lured by the newest online fashion trend: invitation-only shopping, pioneered by the French site vente-prive.com.

"There is a demand for designer fashion at markdown prices," says Mr Salter. "And when it's presented as a private sale, it not only protects the brand, but also gives the consumer the idea that they are within an inner circle."

In 2007 the Gilt Groupe – www.gilt.com – launched in the US while UK site Cocosa – cocosa.com – launched in 2008.

The Gilt Groupe is the brainchild of Alexis Maybank and Alexandra Wilkis Wilson, and offers 36 hour-long sales of styles from a single designer. Distinctly American in flavour, the group has previously offered brands such as Michael Kors, Oscar de la Renta, Valentino, Thakoon, Anthony Nak, Botkier and Shoshanna.

Cocosa, by contrast, is the brainchild of Bauer media, which owns British women's magazine Grazia.

"It's a way of leveraging our magazines on line," explains Cocosa's managing director Andrew Robb, who says that each 48-hour sale sells the product of a single designer and offers a carefully edited selection of past and existing seasons. "I believe the recession will be good for Cocosa, because brands will want new channels to reach the consumer."

Is even the lipstick index being replaced online? Dreamstime

Time for lipstick index to pucker up

Even people in the beauty business are not convinced the lipstick index is a valid measurement anymore. "When you look at beauty in a global way you have to be very careful," says NPD's beauty specialist Karen Grant. "In the US, make-up is the largest prestige beauty category and accounts for 38 per cent of the $8.4bn prestige market. In France, make-up accounts for only 14 per cent of sales, while fragrance accounts for 64 per cent, so would a lipstick indicator really be what you're looking for in France?" She adds that in the US, make-up has been the fastest-growing beauty category for the past decade, with lip-gloss in the ascent, but lipstick sales are actually declining. Any uptick in lipstick sales has been short-lived – the last one happened in the two months following 9/11, and they have recurred relatively rarely since then.

"Lipstick has been off the dial for a long time, but I'm totally obsessed with it," says New York-based innovator Poppy King, who launched Lipstick Queen in January 2007. Although Ms King is realistic about lipstick's power to defy the downturn, she remains upbeat.

Though "the impulse buying of beauty in the Sex & The City era is over", because her business is about a small, affordable item she still plans on wider distribution and hopes for her best year ever in 2009.

"A new make-up look, or even a lipstick, is a much cheaper way of changing your look than buying a new outfit," says Nicky Kinnaird, founder of the beauty company Space NK, which has 62 stores in the UK and Ireland and 13 in the US. Still, Ms Kinnaird believes 2009 "will be a period of consolidation, whilst still keeping our eyes on real estate market opportunities". With people spending more time at home Ms Kinnaird has seen sales of scented candles grow, rather than lipstick.

Meanwhile, Bliss founder, Marcia Kilgore, shifted from luxury to value in 2006 with the launch of beauty brand Soap & Glory. In 2008, the brand notched up sales of £18.2m with the line. "I am democratic at heart, and believe that all people should have access to great product and great design," says Ms Kilgore. "I love to make the masses happy – and it doesn't cost a lot more to do that."

Elisa Anniss

ONLINE EXCLUSIVE

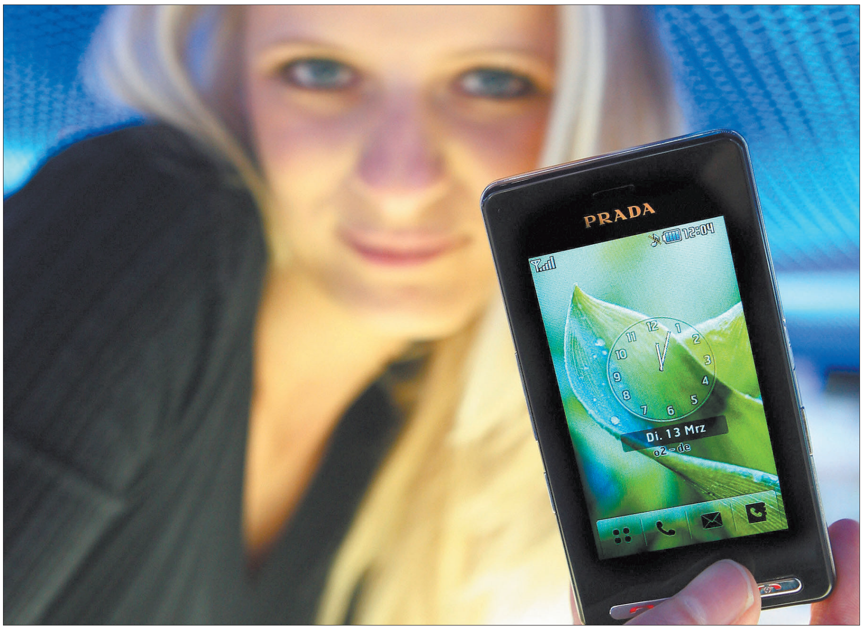
Jonathan Birchall analyses global retail trends based on data from credit card sales **www.ft.com/luxuryretail**

Business of Luxury

Horrors of past are now just a memory

LICENSING

Lucie Greene investigates whether the benefits outweigh the dangers of diluting the brand



Tapping the brand: the Prada phone introduces the luxury label to a younger generation AFP/Getty

Mention licensing to luxury brand executives and chances are you'll be greeted with a shudder. Memories of the 1970s and Pierre Cardin's ignominy are still fresh as ever. But these are testing times, particularly for younger brands low on resources, not to mention publicly-traded companies, where profitability – recession or no recession – is necessity, not choice. There's no question licensing can help. And there's no question we are seeing a thaw.

According to Luxury Briefing – an industry information service – the $192bn licensing business is set to grow by 4.7 per cent over the next few years, with a significant proportion of this from the luxury industry.

Guy Salter, deputy chairman at Walpole, a luxury organisation, admits: "Luxury licensing is having a renewal, but it's gradual. There has been a renaissance as people have seen that it can play role as part of balanced portfolio. Although, everything is relative. It's never going to be like it was in the 1970s."

A quick round-up of the past year also reveals a slew of licensing deals. In December Gucci Group (owned by PPR) divested its perfumes and cosmetics division YSL Beauté to L'Oréal (YSL, Stella McCartney, Oscar de La Renta, Boucheron and Ermenegildo Zegna products). Meanwhile, children's wear witnessed a giant luxury-licensing boom, with virtually every designer hopping on board, including Ballantyne and Jean Paul Gaultier who joined recent converts Little Marc Jacobs, Moschino, Chloé and John Galliano among others.

In menswear, Roberto Cavalli signed with Gibò and Marc Jacobs signed over its menswear to Renzo Rosso's Staff International. Vera Wang's Lavender Label now has a licence for accessories with the Accessory Network Group; DKNY has licensed out intimate apparel to Maidenform Brands Inc for spring 2009; Marc Jacobs has licensed swimwear to Anywear Swimwear; and Jil Sander has licensed inner wear and swimwear. Finally, Prada signed a license for electronics, Armani and Versace for hotels, and Marc Jacobs for condoms.

Still, to Ilaria Alber-Glanstaetten chief executive at Provenance, the luxury arm of M&C Saatchi, these deals do not indicate a strategic shift.

"If you look closely at the history of most brands, there was always a level of strategic licensing," she says, pointing out that while there's undoubtedly been growth in the area, most current licensing deals are occurring in specialist or peripheral categories such as swimwear or accessories, and usually involve smaller or independent labels, rather than key powerhouse brands.

Often, they are also kept within specific regional markets. "There has been significant licensing in children's clothing area because they don't have the capability to distribute the product themselves," says Steven Ekstract, Publisher of License! Magazine. "It's the same with eyewear – only two or three manufacturers produce all the eyewear for designer brands. But they do a good job; produce good designs, so the relationship works well."

Within beauty and fragrances particularly, licensing can also be extremely profitable. Following its licence deal Gucci Group's YSL division reported its first-ever positive recurring operating profit in the financial year 2008.

> 'It's all very well to say: 'more control' but appeasing that is a different matter. It's very challenging to police'

For smaller brands with limited resources, licensing product categories (if handled well) also remains a good way to expand and build presence in the market – see Topshop's licences with young British and American designers, and the agreements between young British designers including Giles Deacon, Danielle Scutt, Peter Pilotto, Todd Lynn, and Preen and London-based eyewear manufacturer Linda Farrow.

"Licensing gives you a great opportunity to venture into areas that you wouldn't normally have access to, as the initial financial outlay, product development and manufacturing side is costly, lengthy and complicated," says Lulu Guinness, of the eponymous London-based luxury accessories label, which currently has licences for umbrellas, eyewear (opticals and sunwear), bedlinen, MacClaren baby buggies, as well as Japanese licences for gloves, small leather goods, and handkerchiefs sold exclusively in Japan. Still, Guinness points out a key difference between today's licences and those of the past: "Licensing only works when you have a rigorous signing-off procedure and if you are absolutely stringent during the design processes."

"It helps that it's easier to manufacture good quality inexpensively," says Mr Ekstract. "It used to be that you could really see the difference between the high street and designer. Now the gaps are much narrower."

Today designers retain creative control, the contracts are shorter, and are carefully managed. "Brands have learnt their lessons. They make sure products meet quality standards. You can't afford to lose the credibility with consumers or that's it, it damages the brand," says Mr Ekstract.

Thus distribution and discounting are all now seen as a key areas for regulation. Last April, for example, the European Court of Justice ruled that trademark owners could legally oppose the resale of their goods by discount stores. The move followed the case of Christian Dior Couture against its former licensee Société Industrielle Lingerie (SIL) for selling Dior lingerie to discount retailer Copad International.

"It's all very well to say: 'more control', but appeasing that is a different matter. It's very challenging to police, particularly if in remote territory like China," says George Wallace, Director at MHE Retail, a retail consultancy, who also cautioned against relaxing licences in different territories. "The market today is more global. You have to have a consistent image throughout, and quality. You don't want the customer to see three different iterations of the brand."

So, says HSBC luxury analyst Antoine Belge, while "smaller brands may turn to licensing, large established brands won't. Louis Vuitton has no licences, and I can't see that changing – whatever the climate. It's more likely that larger brands will consider dropping a category if they are under pressure, rather than licensing it out."