# Emerging Competitive Strategies in the Luxury Sector: Exploiting the Mass-Market *vs* Refocusing on the High-End Segment*

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## Abstract

The distinctive characteristics of European luxury firms - excellence in quality, brand exclusivity, rarity and craftsmanship of products- combined with their global vocation have allowed the luxury industry of achieving worldwide a leadership position in all market segments. The growth in demand for branded products, driven by both the dynamics of spending in emerging economies and the sustained growth of the HNWI segment, along with the increased democratization of luxury carry two main effects. On the one hand, an expansion of the market, with a positive impact on financial performance of firms; on the other, the increasing over-exposure of brands, with negative impact on the perception of exclusivity both of the products and the brand's image. In this framework, the paper analyses emerging competitive strategies in the European luxury sector, which are not necessarily mutually exclusive: leveraging the opportunities offered by the mass-market demand through an integration of the retail channels versus the re-focusing of the brand on the high-end segment to strengthening the perception of exclusiveness and rarity of the product as well as the aspirational value associated with the brand prestige. The limits of the paper are connected to the absence of case studies to reinforce the analysis of emerging competitive strategies of luxury firms.

**Keywords**
luxury demand drivers; brand prestige; product innovation; democratization of luxury; strategic re-positioning choices

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## 1 Luxury: The Distinctive Features of a Global Innovation-Driven Industry

The concept of luxury does not lend itself to precise, exhaustive definitions. First of all, a distinction should be made between the concept of luxury in general and luxury products/brands (Beverland, 2004). The former is linked to the notions of quality, prestige, elitism, and the "art of living", which are related to ideas of exclusive pleasure and wellbeing (Goffman, 1951; Phau and Prendergast, 2000; Dubois and Czellar, 2001, 2002; Kapferer, 1997). The latter has specific strategic implications linked to the ability of an enterprise to offer highly differentiated products characterized by excellent quality, exclusivity, uniqueness, rarity, craftsmanship in the manufacturing process (Dubois and Paternault, 1995; Della Bella, 2002). More specifically, according to Prendergast and Phau (2000), luxury brands feature five main characteristics, i.e. they must evoke exclusiveness, have a well-known brand identity, enjoy an excellent reputation, generate a perceived high quality, and finally they have to achieve high levels of customer loyalty. With specific reference to the brand, Kapferer (1997) identifies three separate types of luxury brands, i.e. labels (or *griffes*), which have a strong identity and include products of pure and unique creation, which potentially embody the precept of perfection; luxury brands (strictly speaking), which offer products in limited editions featuring hand-made craftsmanship; high-end brands-products, which stand out for their mass productions of very high quality as compare to the relevant benchmark. As is well known, consumers associate these products with a status-related symbolic value that goes well beyond the specific intended use and accounts for their willingness to pay a premium price. As McKinsey points out, "*luxury brands have constantly been able to justify a high price, i.e. significantly higher than the price of products with comparable tangible functions.*" It should also be noted that, while price continues to be a necessary condition in the concept of luxury, it is no longer a sufficient conditions. As a matter of fact, Fabris (2003) noted that luxury "is a complex set of meanings that largely transcend the economic value."

In a product-oriented perspective, luxury brands are traditionally associated with the presence of positional goods, i.e. goods whose value to the owners is linked to the perception that others have of the products themselves. Because of these distinctive features, the consumer's satisfaction is the result not only of the usefulness and qualitative characteristics of the luxury product, but also, and especially, of the social status and prestige that it conveys to the owner.

The remarkable rise in the demand of branded products, driven by the spending patterns developed in emerging economies, by the worldwide growth of the High Net Worth Individual segment and, last but not least, by an increasing accessibility of luxury to the mass market segment (linked to luxury democratization and trading-up phenomena) generates two major effects. On the one hand, the target market for luxury enterprises is expanding, with a positive fallout on their economic and financial growth, while, on the other hand, an increasing over-exposure to the brand has a negative impact on the perception of exclusiveness and rarity of the products, which consequently lowers their positional value (Berry, 1994; Nueno and Quelch, 1998; Catry, 2003; Silverstein and Fiske, 2005). Starting from the 1990's, such dynamics began to influence the distribution strategies. More specifically, the development of the retail channel led enterprises in the luxury sector to invest heavily in new openings of large flagship and single-brand stores in the major cities worldwide and, in more recent years, in e-commerce and, lastly, in outlet stores. While this largely contributed to strengthening sales and profits, it also caused a progressive saturation of the market, thus exposing luxury brands also to the risk of cannibalization (Moore et al., 2010).

This evolutionary pattern is now affecting the whole luxury industry, forcing companies to reposition themselves and their brands competitively along two main lines, which are not necessarily mutually exclusive. One consists in leveraging the opportunities offered by the mass-market demand through an integration of the retail channels (flagship stores, directly operated single-brand stores, e-commerce, outlet stores), while the other requires re-focusing the brand on the high-end segment with a view to strengthening the perception of exclusiveness and rarity of the product as well as the aspirational value associated with the brand prestige (Phau and Prendergast, 2000; Dubois and Paternault, 1995).

The above-mentioned need for luxury enterprises to preserve the positional nature of goods and services over time, which is inherent in the very concept of luxury, has a few important consequences. First of all, it calls for investments in the protection of intellectual property so as to curb the risk of counterfeiting to which both the innovative technologies underlying the production process and the brand, design, and models are exposed. It should be noted that the protection of intellectual property in the luxury industry features peculiarities as compared to other sectors since the regulatory and legal instruments (e.g. patents and copyrights) are not suitable for providing protection against piracy, while legal instruments often turn out to be ineffective in safeguarding technological innovations developed in this industry (Raustalia, Sprigman, 2006; Cohen et al., 1997). Secondly, the positional nature acts as a stimulus for product innovation, often in partnership with public and private players in the area of scientific research. Just to make a few examples, Lange & Söhne set up an in-house school to offer vocational training for master watchmakers; Mercedes, BMW, and Porsche have an ongoing cooperation with universities and scientific research institutes aimed at developing innovative technologies and offering qualified training to their technicians and managers; several other luxury brands also invest in in-house research centers with a view to fostering product innovation, for example the French Group LVHM has recently built a dedicated R&D center for perfumes and fragrances in the Loire Valley.

The uncertainty and reduced efficacy of the regulatory instruments designed to protect intellectual property rights in the luxury industry act as additional stimuli in product innovation since they force companies to replace counterfeited goods with new products capable of renewing the status of exclusiveness and social distinctiveness associated with the such products, which actually drive the demand of these goods. As Raustalia and Sprigman (2006) observed with reference to *haut couture* products, "*More fashion goods are consumed in a low-IP world than would be consumed in a world of high-IP protection precisely because copying rapidly reduces the status premium conveyed by new apparel and accessory designs, leading status-seekers to renew the hunt for the next new thing.*"

The central role played by artistic creativity and manufacturing craftsmanship in the production process of luxury enterprises does not undermine the importance of innovation (Dumas, 2009). Indeed, luxury is an innovation-driven industry in which three different, though complementary, dimensions of innovation merge to act as drivers of competitiveness of the individual enterprises and as a springboard for growth for the whole sector, i.e. technology-guided, science-driven innovation; innovation driven by artistic creativity; innovation connected to the ability to continuously innovate the artistic and handicraft abilities that are deeply rooted in the culture of a territory, which often result from century-old traditions. With reference to the latter dimension, the survival of handicraft expertise and manufacturing skills is strategically important for nurturing excellence in quality of luxury goods. It is no coincidence that the biggest enterprises in this sector are strongly committed to promoting and supporting traditional arts and crafts, which are deeply rooted in the territory, and to promoting vocational training of young talents in these areas, which require highly qualified human resources. Suffice it to think, for example, of the French *maison* Hermès, which is currently building a big training center near Paris to be devoted to its employed craftsmen in charge of manufacturing accessories.

Overall, these elements characterizing the luxury industry translate into the need for enterprises to invest multiple, heterogeneous resources and to coordinate highly diversified skills which are often located in different countries with often non-homogeneous cultures, using flexible forms of connections between the enterprise and the different players involved in the production and innovation processes (e.g. creatives, master craftsmen, scientists, researchers, managers). This is indeed a necessary requirement to foster the value of strategic intangible assets (i.e. creative abilities, technological innovation, high-level training of human resources, enhancement of crafts, etc.) over time. For example, since 2011the French Group LVMH has been organizing an annual celebration of the "*Journées Particulières*", i.e. an event during which the public can enjoy a hands-on experience of the handicraft work carried out by some of the most important luxury companies thanks to guided tours of the laboratories that manufacture leather products, high-fashion clothes, prestigious wines, and luxury branded watches, all falling within the scope of the French group.

This "ecosystem of knowledge" stimulates the experimentation of business and governance models based on collaborative approaches, which privilege a long-term strategic orientation. In this perspective, the interest for an analysis of the luxury industry seems to be connected not only to the major economic role that it plays in several country-wide systems, but also to its connotation as "laboratory" of strategic and organizational innovation and of new business models.

One of the most important elements shared by luxury enterprises and luxury brands is the central role played by product and service differentiation in the strategic positioning of enterprises. The ability to create and maintain their allure of prestige over time, to guarantee qualitative excellence over the long term, and to foster exclusivity associated with the enterprise's products and brand is a critical success factor that needs to be constantly nurtured by the three innovation dimensions analyzed above. Developing new concepts and a distinctive brand identity - imbued with symbolic values, recognized and recognizable on a global level – is key to achieve brand differentiation, which indeed drives all strategic positioning choices (Kapferer, 1997; Nueno and Quelch, 1998).

### *1.1. The Contribution of the Luxury Industry to the Competitiveness of the European Economic System*

The luxury industry is quite vital in Europe, which historically has been the leader on the global market of luxury goods. Overall, in 2012 the European luxury brands accounted for approximately 70% of the total turnover, with an overall value of 428 billion Euro out of an estimated total amount of 600 billion Euro worldwide (Bain/Fondazione Altagamma 2012; Frontier Economics, 2012), i.e. approximately 3% of the EU GDP (Table 1). Exports accounted for approximately 60% of the turnover, i.e. 10% of the total exports from Europe. According to Euromonitor, the Eurozone includes four of the top ten luxury markets in the world: Italy (3rd), France (4th), Germany (7th), and Spain (9th); the United Kingdom is the 6th largest luxury market worldwide. The vitality of the European industry is reflected in its leadership in almost all market segments. As a matter of fact, except for luxury hotels and yachts, the European brands account for over 60% of the luxury market worldwide in terms of sales with peaks of close to 70% in the segment of personal luxury goods (watches and jewels, fashion, perfumes and cosmetics, accessories, leather items) and 80% in the luxury cars and design furniture segments. The competitive positioning of the European industry is the result of its century-long tradition in handcrafted luxury products and of its cultural and artistic heritage. This heritage of skills combines with a strong propensity to innovation that characterizes enterprises in this sector, which are also committed to passing down crafts and skills to the future generations.

**Table 1. The worldwide luxury industry broken down by segment and geographical area**

| | **Global Value (billions euro)** | **Europe (billions euro)** | **Rest of the World (billions euro)** |
|---|---|---|---|
| Luxury cars | 245 | 206 | 39 |
| Personal luxury goods | 173 | 128 | 45 |
| Luxury hotels and leisure | 93 | 30 | 63 |
| Luxury wines and spirits | 40 | 25 | 15 |
| Luxury food | 33 | 21 | 12 |
| Design furniture | 17 | 15.3 | 1.7 |
| Luxury yachts | 6 | 2.8 | 3.2 |
| Total | 607 | 428.1 | 178.9 |

Source: Frontier Economics, *The value of the cultural and creative industries to the European economy*, p. 15, 2012, London

Overall, sales of luxury goods in 2013 reached a total amount that – depending on the estimates – ranges from 217 billion Euro (data source: Bain-Fondazione Altagamma) to 230 billion Euro (data source: Boston Consulting Group, 2014). A recent survey conducted by the Boston Consulting Group (BCG; 2014) foresees that luxury consumers will increase exponentially from the current 380 millions to 440 millions by 2020, with an overall expenditure of up to 880 billion Euro. Such growth shall mainly be driven by the "Core" segment (i.e. high-end demand) where the average annual spending for personal and experiential luxury goods (excluding cars) amounts to € 10,000, with 10 millions of new consumers by 2020. According to Euromonitor, the Emerging Markets of Asia Pacific, Latin America, Middle East, and Africa accounted for a combined 9% of luxury market in 2008; this figure leaped to 19% in 2013 and is projected to growth to 25% in 2025. This trend is driven by the combined forces of urbanization, economic development, and the love of luxury (Deloitte, 2014). By 2019, China is expected to be the second largest market for luxury goods, following the United States; Brazil is a promising growth market for luxury goods with its surging middle class.

Thanks to the strong global vocation featured by luxury enterprises and to the remarkable increase in demand (both in terms of number of consumers and in terms of per-capita expenditure), the industry as a whole managed to successfully overcome the economic crisis. Indeed, some sectors, such as accessories and fashion, continue to record impressive growth rates, especially in the high-end segment, which drives the development. Overall, the growth forecasts for the luxury industry in the next decade remain largely positive (with an estimated percentage ranging from 7% to 9%), especially in the United States (again the world's leading luxury market in terms of demand) and in the emerging markets, driven by China, India, and Brazil (Bain & Company, 2013; Frontier Economics, 2012).

Because of the evolutionary processes that are currently under way in this sector and due to the growth forecasts for the luxury industry worldwide, companies in this business need to gain more in-depth knowledge of their customers in terms of purchasing behaviors and drivers for approaching luxury goods. Against this backdrop, segmenting the demand becomes strategically important and also acts as a crucial frame guiding strategic positioning choices on both domestic and global markets.

## 2 Evolutionary Demand Drivers and Strategic Re-positioning Choices

The luxury market is traditionally divided into three macro-segments, linked to corresponding types of products and consumers (Kapferer, 2006):

- Inaccessible luxury includes few goods, which are often made-to-measure, of extremely high quality and hand-made, distributed in a highly selective manner with extremely high prices; this is the market of high-end consumers;
- Intermediate luxury includes products whose brands and style mirror those of inaccessible goods; although these products are not custom-made, they can be adjusted to the consumers' needs and are selectively distributed at medium-high prices (an example is offered by clothes that fully or partly duplicate haute couture models);
- Accessible luxury corresponds to the so-called "*masstige*" segment and includes branded products that are mass manufactured and affordable to those consumers who look for luxury products at affordable prices.

The recent evolutionary dynamics characterizing the luxury industry indicate a need to break down the sector into sub-segments in order to better capture the features of consumers on a global level, as well as the major role played by cultural and geographical elements in purchasing choices. A recent survey conducted by the Boston Consulting Group (2014) offers a breakdown of luxury demand into 12 segments, 8 of which are global, 2 country-specific, and 2 gender-specific (Absolute Luxurer, Megacitier, Experiencer, Socialwearer, LittlePrince Fashionista, Status Seeker, Classpirational, Luxe-Immune, Rich-Upcomer, TimelessProper, Omnigifter). Each segment corresponds to a specific consumer profile which is accurately defined not only in socio-economic and demographic terms, but also, and especially, in terms of attitudes and behaviors, e.g. search for product uniqueness, fashion attitude, degree of emotional connection with the brand, brand loyalty, degree of independence in purchasing choices, search for social status, etc. The first three segments (Absolute Luxurer, Megacitier, Experiencer) account for over 50% of the total spending for luxury goods, with an annual expenditure in excess of 15,000 Euro.

Besides the definitions used and the large number of segments that can be identified, what should be noted is a polarization of global demand onto two macro-categories which, with some degree of approximation, correspond to the high-end segment (i.e. inaccessible luxury) and the Masstige segment (i.e. "democratic" luxury). While the importance of sub-segmenting for driving corporate marketing policies depending on the different demand components is not to be questioned, from a strategic and business model standpoint, competitive positioning decisions are increasingly focusing, on the one hand, on demand from the accessible luxury segment, where the expectation is to obtain big profit margins in a relatively short time and to support the global strength of the brand, and on the other hand, on exclusive luxury, especially the high-end sector.

The phenomenon underlying the first approach is known as "democratization of luxury" (Kapferer, 2006; Rémaury, 2002) or "mass affluence" (Nunes, Johnson and Breene, 2004), whereby the traditional luxury goods (watches, jewels, clothes, perfumes, etc.) are affordable to a mass of potential consumers. Indeed, masstige luxuries are those luxury products that are targeted to broad demand segments comprised of consumers who follow the most popular trends and brands and, by purchasing such goods, aim at being included in a specific community and at acquiring a social status (Silverstein and Fiske, 2003). According to several authors, this phenomenon of progressive democratization of luxury reflects an epochal change in demand, one which is bound to strongly affect the marketing strategies and luxury brand positioning by enterprises (Twitchell, 2002; Radon, 2012; Atwal, Williams, 2009). Some authors use the term "bandwagon" to describe the specific purchasing behavior adopted by this demand segment. Brands such as Gucci, Versace, Luis Vuitton have long been pursuing supply extension strategies to cater for the mass market.

The "luxury democratization" phenomenon translates into progressive downscale extension strategies (Dall'Olmo Riley et al., 2013), whose goal is to enhance the brand from an economic and financial standpoint by launching new production lines sharing the same brand but with a lower price. While upscale extension policies tend to have a positive impact in terms of the premium price that consumers are willing to pay, downscale extension policies feature a number of critical issues. First of all, consumers tend to associate low price with poor quality, which obviously implies the risk of brand image dilution (Michel and Salha, 2005). In other words, consumers attribute a lower level of quality and prestige to the core brand. Some studies, however, demonstrate how consumers' perceptions vary considerably depending on the degree of correlation between the new products and the core brand (Taylor and Bearden, 2002). More specifically, when products share few similarities with the core brand, price is an important component in evaluating a brand extension strategy. Conversely, when the extension strategy is pertinent to the core brand, an association with the core brand features is more important than price. More recent studies evaluating the impact of downscale extension strategies on consumers' perceptions and purchasing behaviors emphasize how important it is to consider the differences between prestige brands and luxury brands (Dall'Olmo Riley, Pina, Bravo, 2013). According to these authors, the former are less exposed to the dilution effect than luxury brands. Therefore, it is crucial that enterprises know exactly what the consumer's perceptions are, both in terms of the core product and of the new product, in order to preserve the exclusivity features that characterize luxury products. As a consequence, the positional value of luxury goods decreases, also due to a growing availability of counterfeited branded products which, by association, erode the social image of the corresponding branded product (Della Bella, 2002 Foray, 2010). Added to this, there is a risk of cannibalization, which all brand strategies and line extension approaches are exposed to.

There are also exogenous factors, especially those linked to the competitive macro-environment, that may undermine the size of the Masstige segment (Silverstein, Fiske, 2003). For example, the economic crisis that has hit all industrialized countries in the past few years has progressively contributed to reducing the size and strategic importance of the mass market. One of the more recent phenomena that are now gaining momentum, especially on the mature markets that have traditionally driven demand (France, Italy, Japan, United States), is the increase in "estranged" consumers who state their intention to drastically reduce their spending for luxury products, which accounts for approximately 4 billion Euro in turnover for the industry (Boston Consulting Group, 2014).

Conversely, what is taking place on a global level is a remarkable growth (both in terms of size and of sales) of extreme or inaccessible luxury goods, with demand driven by a search for values that are inherent in the very concept of luxury, i.e. quality, exclusiveness, rarity, handicraft, timeless classical quality, valuing of the "Made in" as a strategic asset as compared to more exterior aspects that are more pursued in the Masstige sector (brand recognition, aesthetic component, design aesthetics, coolness). The strategic value of these assets for such demand segment is confirmed not only in mature markets where demand comes from the European and US elites, but more and more also in emerging markets, especially China and South Korea, where the important role attributed to the inherent values of luxury is a driver of purchasing choices and brand loyalty decisions. More specifically, authentic and highly sophisticated luxury results into a strong expansion of demand for experiential luxury, which drives the success of sectors such as home furniture, hotels, holidays, and wellness. To seize the opportunities offered by this area of demand, luxury enterprises are more and more often integrating sales of products characterized by qualitative excellence and craftsmanship with the supply of multi-sensory purchasing experiences, which also generates a renewal of the points of sale. Against this background, other trends are gaining momentum, namely the "made to measure", unbranded limited editions, and unique prices.

It should be noted that these two strategic options of market coverage (namely, Masstige versus High-End) are not necessarily mutually exclusive. Over the past few years, the development of large corporate conglomerates (e.g. LVMH Group, Richemont Group, PPR, Gucci) with brand portfolios that include both exclusive lines targeted to the high-end market and mass-luxury products, reflects the willingness on the part of enterprises to seize the opportunities offered by both demand segments, without running the risks that would derive from a brand over-exposure. An example of this approach is offered by the strategy put in place by the LVMH Group that is currently managing a portfolio of over 60 luxury brands. The recent choice made by the Maison Luois Vitton to invest in a new line of "hyper-luxury" accessories stems from the willingness of the Group managing the brand to re-affirm product exclusiveness as the foundation of brand identity and brand reputation. As a matter of fact, after a long period of growth and after opening up new points of sale, the LVMH brand experienced a dangerous phase of saturation, both on the level of the points of sale and of image, most especially in Asian countries. Indeed, China, which has always been one of the key markets for this brand, started to show a decrease in demand, mainly because of the choice to privilege more exclusive brands such as Hermès, Bottega Veneta, or Prada. The same sales strategies are now being put in place for no-logo products that can easily be appreciated by the most demanding consumers due to their excellent quality, handicraft quality in manufacturing, attention to details, which have always inspired the French Maison.

Overall, the trends that are globally emerging on the demand side show how the ability of luxury enterprises to preserve the brand identity value over the long term rests more and more on the value attached to distinctive product/service elements, as well as on a deep understanding of the cultural elements that affect purchasing behaviors and brand selection. Indeed, luxury products, especially those targeted to the high-end segment, are characterized by their strong country-specific connotation as an expression of the cultural and artistic heritage of a country, as well as its handicraft manufacturing tradition.

While the purchase of luxury products is largely determined by the status attached to them in a specific cultural context – in the broadest sense, – it also affects the purchasing behaviors, consumption habits, and the attitude that consumers have vis-à-vis the brands. These factors raise an issue as to the validity of a global strategy for approaching international markets, especially with regard to the emerging economies – which are now driving demand – where the local culture seems to strongly influence the perception of luxury brands and the related purchasing motivations (Shulka and Purani, 2011; Dubois and Gilles, 1994; Leclerc *et al.* 1994; Dubois and Gilles, 1994; Mason, 1993). The growing trend to progressively replace the demand for luxury goods with demand for experiential luxury products seems to be bound to enhance the important role that cultural traditions and social values play in a country in shaping the modalities and the meaning of experiential consumption. This forces enterprises to combine their global strategic approach with an ability to adjust their marketing leverages to the local values and culture in order to seize the competitive opportunities linked to the specificities of the local demand. This is reflected on the increasing importance given to the concept of the "*Made-in*", which qualifies products, excellence, taste, style and, more generally, the *art de vivre* of a country.

This perspective, which is gaining more and more momentum, translates into the need for enterprises in the luxury industry to re-think their strategic approach to the international market with a view to transforming the cultural gap between countries – which is generally seen as a constraint to an international expansion strategy – into a competitive opportunity acting for the benefit of both the individual companies of this sector and of the industry as a whole. These trends open up interesting opportunities for research and analysis of both the strategic behaviors and of the business models that are currently emerging in this industry, which are still poorly investigated in the international business literature.

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