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Luxury market performance in global economic downturns: is this time different?

The luxury market is unique, mainly due to the fact that its products are consumed for social distinction. This has helped companies in the segment to outperform other sector-segments over the past years.

Nevertheless, the luxury market is facing important challenges, notably regarding counterfeit products, a risk for companies, and e-commerce, which is disrupting how business is conducted. In addition, the market is not immune to challenging economic conditions. Global economic activity is currently experiencing a slowdown: Coface forecasts a global GDP growth rate of 2.9% in 2019 after 3.2% in 2018, and this will have an impact on some luxury products.

Looking ahead, the rise of emerging markets' middle classes – especially in China – presents great opportunities. Despite global economic slowdown, we are therefore expecting the luxury retail market overall to be resilient, notably benefiting from the rise of Chinese consumers' appetite for luxury.

Luxury Market: Bright outlook despite global economic slowdown ahead

How does the luxury market hold up during global recessions?

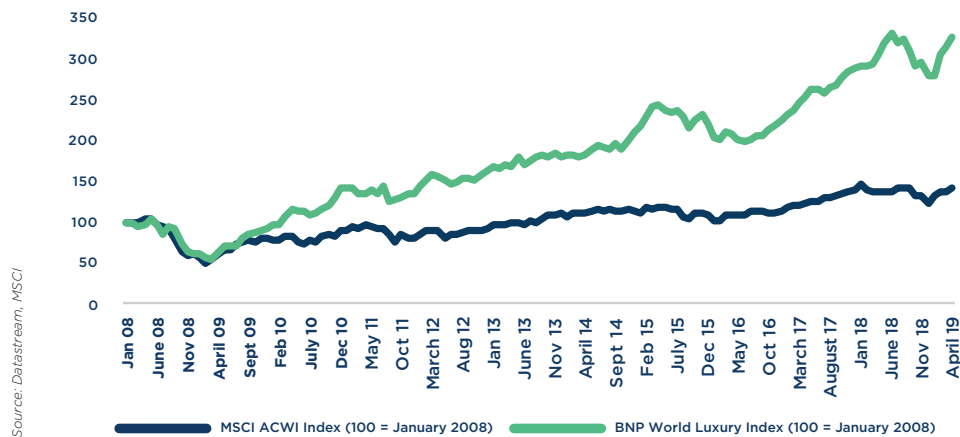
Luxury companies have outperformed other companies in the general market over the past years (**Chart 1**). Nevertheless, the luxury market is not immune to economic recessions: even those who can still afford luxury products may delay their spending during an economic crisis, as a method of self-restriction and/or a lack of confidence for the future. The resilience of luxury brands to recessions also depends on which demographic they are targeting: companies that try to attract a wider

range of clients by including more accessible (and cheaper) products in their offer suffer more because they are in part relying on the middle class¹, who are generally more impacted by economic recessions.

Luxury business is expected to remain resilient despite the global economy downturn

Global economic activity is currently experiencing a slowdown, and a majority of regions worldwide are expected to be impacted (the Middle-East, whose importance on the luxury market is growing, is nonetheless expected to benefit from a sound economic growth). This occurs in a context of rising protectionism, notably with a trade war between the United States and China² that has led to additional tariffs on luxury goods. A deterioration in most economic

1 - Kapferer, J.-N. & Bastien, V. (2009). The specificity of luxury management: Turning marketing upside down. *Journal of Brand Management*, Palgrave Macmillan, 16 (5-6), pp.311-322.
2 - London, M. & Marcilly, J. (2018). US Trade Protectionism: what are the knock-on effects on global value chains?. Coface, available at: <https://www.coface.com/News-Publications/Publications/US-Trade-Protectionism-what-are-the-knock-on-effects-on-global-value-chains>

CHART 1
Luxury market outperforms the rest of the economy³

sectors is thus expected⁴, particularly the pro-cyclical ones such as automotive, chemicals, and retail.

In 2018, luxury companies' sales worldwide reached EUR 1.2 trillion, a 5% increase from 2017 according to Bain & Company (2018)⁵, mainly due to the rising of Chinese consumption of luxury. The major luxury markets are Europe, North and South America (mainly the United States) and Japan: they accounted for 87% of the global market in 2018. However, given that Chinese consumers accounted for 33% of global luxury purchases last year, it is likely that the luxury market will heavily rely on tourists from China to the United States and Europe and their consumption in 2019. On the global scale, the market is expected to be resilient despite the global economic slowdown.

Luxury: a market like no other

Luxury is not just a matter of price or quality, even if luxury goods are typically high quality and expensive. Luxury products stand out from the competition due to their high quality, high price point (compared with other goods of the same category), and most of all their use for social distinction. According to Kapferer and Bastien⁶, "The DNA of luxury is the symbolic desire to belong to a superior class [...] because anything that can be a social signifier becomes a luxury [and] anything that ceases to be a social signifier loses its luxury status". This implies that luxury is consumed towards other people: the consumer wants to be recognised wearing luxury goods. However, no luxury brand can prosper if it solely relies on clients who are only interested in signs of recognition: these clients would drift from one symbol, one logo to another. That is why luxury is also a matter of taste. According to the aforementioned research: functionality comes after hedonism, i.e. the functional characteristics of luxury goods are less important than their appearance.

Globally, luxury brands are managed according to specific rules, named as the "anti-law of marketing"⁷. Academic researchers on the matter settled twenty-four anti-laws of marketing by analysing the behaviour luxury brand should have in order to prosper. These are totally

different from classical rules of brand management, due to the fact that luxury is fundamentally different from other markets. For example, since luxury is notably consumed for distinction, the aforementioned, '24 laws of marketing suggest that if a product is sold too fast, the luxury brand should discontinue it, while in classical business, one would tend to produce it in greater quantity. Moreover, there is a difference between fashion and luxury. Fashion is based upon a process of imitation, and what is fashionable today will no longer be fashionable tomorrow. By contrast, luxury aims at being timeless, and its consumption is driven by a will of distinction for the "happy few".

There is also a distinction between premium and luxury products. The premium market, which provides high quality and therefore expensive goods, is not just a cheaper version of luxury. Firstly, premium goods' prices are justified by their characteristics. Secondly, premium brands are trying to establish their products as the best, and are thus comparing them with other brands. In contrast, luxury brands are not comparative and do not have to justify their prices, as they do not merely sell "products"; they sell "dreams" and "identity" (although the notion of high quality remains important).

HOW COFACE FACTORS THE LUXURY MARKET INTO ITS SECTOR ANALYSIS

Luxury products are everywhere, ranging from champagne to watches, from cars to clothes – any product can become "luxury" if it becomes a social signifier, which is why defining luxury in term of sectorial analysis is delicate. Our definition of luxury is not based on one particular type of product; rather we conducted a cross-sector analysis of the behaviours of both consumers and producers of luxury products. The luxury market is therefore split into several sectors, which each include sub-sectors, e.g. high-end cars, designer clothes, etc.

According to Coface sector analysis, most luxury products can be found in the following sectors: Automotive, Textile-clothing, Retail (e.g. accessories and jewellery), Pharmaceuticals (for perfumery, make-up), and to a lesser extent in Agri-food and Transport⁴.

3 - The BNP World Luxury Index is a stock index of the 20 biggest luxury companies worldwide. The Morgan Stanley Capital International All Country World Index (MSCI ACWI) captures large and mid-cap representation across 23 Developed Markets and 24 Emerging Markets countries. The index covers approximately 85% of the global investable equity opportunity set.

4 - We are referring here to the 13 sectors covered by Coface sectorial analysis, for further information, see: Coface Economic Research (2019), Country And Sector Risks Barometer Q1 2019: The great industrial rotation continues. Coface, available at: <https://www.coface.com/News-Publications/News/The-turnaround-in-the-industrial-cycle-hits-companies-in-the-chemicals-sector-in-Europe-and-North-America>

5 - D'Arpizio, C., Levato, F., Prete, F., Del Fabbro, E. and De Montgolfier, J. (2018). Luxury Goods Worldwide Market Study, Fall-Winter 2018: The future of luxury: A look into tomorrow to understand today. Bain & Company.

6 - Kapferer, J-N. & Bastien, V. (2009), op. cit.

7 - The 24 anti-laws of marketing, 2016, The Fashion Law, viewed March 15, 2019 <http://www.thefashionlaw.com/home/the-24-anti-laws-of-marketing>.

TABLE 1
 Coface Regional Sector Assessments - Q1 2019⁸

| SECTOR | Asia | Central & Eastern Europe | Latin America | Middle East & Turkey | North America | Western Europe |
|------------------|-------------|--------------------------|---------------|----------------------|----------------|----------------|
| Agri-food | Medium risk | Medium risk | High risk | Medium risk | High risk | Medium risk |
| Automotive | High risk | Medium risk | High risk | High risk | High risk | Medium risk |
| Pharmaceuticals | Low risk | Low risk | Medium risk | Medium risk | Low risk | Low risk |
| Retail | Medium risk | Medium risk | Medium risk | High risk | High risk | Medium risk |
| Textile-Clothing | High risk | Medium risk | High risk | High risk | Very high risk | High risk |
| Transport | Medium risk | High risk | High risk | Medium risk | Low risk | Medium risk |

BUSINESS DEFAULT RISK

- Low risk
- Medium risk
- High risk
- Very high risk

New actors are disrupting the market outlook

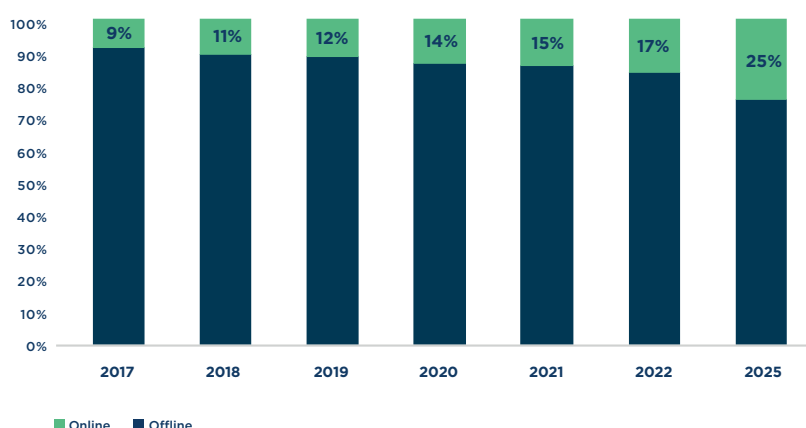
Counterfeit luxury products

This desire for social recognition explains why some consumers are attracted by counterfeit luxury goods, which offer products that look the same but at a much lower price. Although there is not always a clear distinction between consumers of luxury goods and consumers of counterfeit goods⁹, consumers sometimes buy counterfeit products unintentionally. This occurrence, exacerbated with the development of e-commerce, is damaging brand value: a study¹⁰ conducted in the United Kingdom shows that 66% of consumers who have unintentionally bought counterfeits lose trust in the original brand, while 44% confirmed they have stopped buying an item because they feared it may be counterfeit. With the rise of counterfeit goods market, which is expected to reach USD 1.8 trillion by 2020¹¹, luxury brands are trying to combat the distribution of such goods due to the negative knock-on effect it has on their business. However, this damage is somewhat mitigated by the fact that counterfeits can increase awareness of the original brand.

The e-commerce revolution

At a global level, the continuing growth of e-commerce is hurting physical, brick-and-mortar shops¹², and companies that do not adapt are going bankrupt. According to eMarketer, 12% of global retail sales in 2018 were made online, and this share is expected to grow to 18% in 2021. The luxury market is not an exception to the rule: in 2018, online sales represented 10% of luxury sales, and this share is expected to reach 25% in 2025 (Chart 2). However, some brands resist selling their products online as they fear counterfeits and losing customer contact and shopping experience. The notion of customer experience is crucial for the luxury market since part of the “dream” used to incite luxury purchases is partly offered via the shopping experience in a luxury shop.

CHART 2
 Share of offline and online sales in the total luxury goods market



Source: Statista, Bain & Company

Rising importance of emerging economies' consumers in the luxury market: the Chinese case

Emerging markets in all regions are seeing an increase of their “wealthy” population, even in low income countries with very high levels of income inequality. This is bringing new consumers to the luxury market, with China being the most important new market frontier.

The Chinese luxury market is indeed growing very fast: Bain & Company forecasts Chinese consumers will account for 46% of the global luxury market in 2025, up from 33% in 2018 (Chart 3) and half of their luxury purchases will be made in China against 24% in 2017. Chinese Premier Xi Jinping’s anti-corruption campaign, launched in 2012, has had negative knock on effects on the luxury market as luxury products were very present as corporate gifts, leading to allegations of corruption. Nonetheless, the market has since recovered, driven by increasing luxury purchases by millennials and the growing middle class. Moreover, Chinese consumers’ habits will benefit luxury brands, as

8 - Coface Economic Research (2019), op. cit.

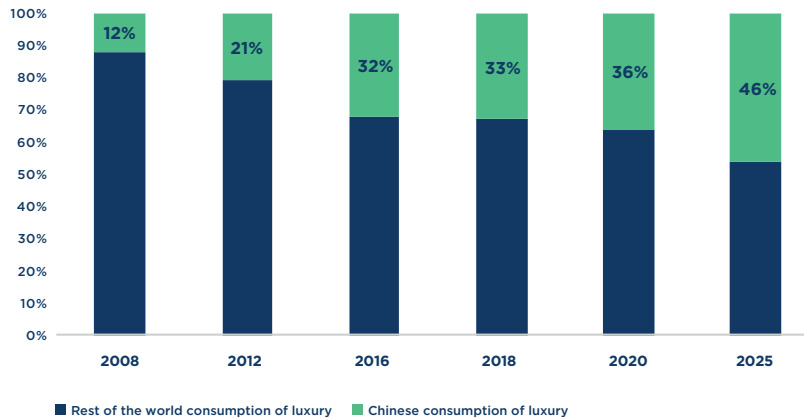
9 - In some cases, these groups can overlap: a study showed that although “genuine” consumers of luxury products will not substitute luxury goods with counterfeits, they will buy fake products in addition to their luxury goods. For more information: Wiedmann, K., & Hennigs, N. (2013). Luxury Marketing. Wiesbaden: Gabler Verlag.

10 - Incopro (2019). Counterfeit products are endemic - and it is damaging brand value, available at: https://www.incoproip.com/cms/wp-content/uploads/2018/11/2018_Incopro_Market-Research-report.pdf

11 - Global Brand Counterfeiting Report, 2018

Research Ltd - <https://www.researchandmarkets.com/reports/4438394/global-brand-counterfeiting-report-2018>

12 - Coface Country & Sector Risks Handbook 2019 (2019), Retail p16, available at: <http://static.coface.com/handbook/coface-country-sector-risks-2019.pdf>

CHART 3
Increasing share of Chinese consumers in luxury market

Source: McKinsey & Company, Bain & Company

they mainly shop either at official stores or at duty free shops, reducing the risk of buying counterfeits. Despite China's anticipated economic slowdown - Coface estimates China's GDP growth in 2019 will be 6.2%, down from 6.5% in 2018 - this trend does not seem likely to change thanks to the rapidly growing middle class and the government's effort to boost domestic consumption. The resilience of luxury market at global level will therefore be linked to Chinese economic

activity, as the Chinese market is becoming more and more important. At a global scale, the luxury market is expected to remain in good shape in the medium term. Although e-commerce and counterfeit products constitute risks to luxury companies, Chinese growth is bringing new consumers and new companies, and counterfeit products do bring some benefits, as previously discussed.

DISCLAIMER

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