Luxury: An Industry Between Heritage and Modernity

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The aim of this article is to show that the specifics of the luxury industry mean that, to a certain extent, it is one of the sectors where new business model trends are more clearly visible. Whether this is a question of product differentiation pushed to the limits, the weight of the representative and the immaterial, the globalisation of markets or the need for absolute control over design and distribution in a market where reputation and coherence are cardinal values, the components of the luxury economic model display a level of modernity that would have been difficult to predict twenty years ago.

Luxury companies are the main players in the new age of capitalism referred to by some writers as cognitive capitalism, by others as the economics of singularity, and others still as the economics of the immaterial. Yann Moulier Boutang outlined the main traits of cognitive capitalism[1]. He cites the primacy of the immaterial investment over the material investment and the end of the division of work that holds back innovation in favour of organisations that make the development of quickly-made complex products in small quantities possible.

Olivier Bomsel[2] defines a new type of goods known as "significant goods" which are in addition to the goods of research and experience that economists already know. These significant goods do not specifically serve "a strict demand, but are impulse buys that suggest experiences to the purchaser". The central value of these goods is the message they convey thus underlining the importance of the signalling of the products (through advertising, quality labels, brands…). Taking the example of Louis Vuitton, he feels that a high level of vertical integration is necessary for these types of goods to succeed. It is interesting to note that both writers make the connection between the overall evolution of the economy and the business models necessary to adapt to the economy. Here we wish to show that luxury companies are mines of information on today's economy in terms of the way they function and their organisation. To do so, we will take a micro-economic approach to outline the main characteristics of the different business models in the luxury industry.

The Rebirth of an Industry

In the past, the attitude to the production and consumption of luxury products was not without contrast. The siècle des Lumières defended luxury as is evident from reading Montesquieu, Mandeville, Voltaire or Saint-Lambert's article in the *Encyclopédie*[3]. Luxury was considered to be a source of wealth for individuals and for the state. As such, they were breaking with a long tradition that Henri Baudrillart[4] referred to as "*rigoriste*" (strict), that had notably been supported by the Greek stoics and French moralists (Montaigne, Pascal) who thought superfluous spending was to be frowned upon.

In his *Political Economics Class*[5], Charles Gide tries to bring both strains together. He proposes the idea that luxury consumption

should not have to take the blame for the rapid change in needs and technology: the luxury of one era is no longer a luxury in the decades that follow: " *...At certain times in history, a shirt was considered to be an item of great luxury and constituted a royal gift. A thousand other objects can be said to have the same story […] It is not possible to condemn a purchase from a moral point of view or even from an economic one for the sole reason that it fulfils a superfluous need, that is to say superfluous right now, without being able to predict what will happen in the future*". However, luxury consumption should not take over too great a part of limited production elements (earth, work and capital) so as to avoid the reduction of social well-being.

In the seventies, the theme of industrial redeployment was in vogue and France wanted to shift away from traditional industry. Georges Pompidou mentioned it in a press conference in 1972[6]: "good cooking… haute couture and good exports […] that's all over… France has begun and is well into an industrial revolution". However, in the nineties, luxury came to the fore again: two of France's biggest companies, LVMH and PPR, became world leaders in the sector and the French luxury business contributed significantly to the international development of the country, through exports and investment abroad.

We have estimated that the world luxury goods market is worth 168 billion euros[7], and French companies cover a consequential part of this market. The market can be divided into two segments with a relative share that is practically equal: ready-to-wear[8] and accessories (just over a quarter) on the one hand; perfumes and watches (around 20%) on the other. France has pride of place in a number of specialities (leather goods, high-end jewellery and perfumes).

The different luxury markets in 2010

Sector	Turnover in billion euros	Share of market as a whole
Ready-to-wear	45	27 %
Accessories	44	26 %
Perfumes & cosmetics	37	22 %
Watches & jewellery	32	19 %
Tableware	5	3 %
Other products	5	3 %
Total	168	100%

Source: Altagamma

Luxury has become a veritable industry. The supply chain goes from raw materials to finished products. Luxury companies manage complex value chains that combine production, logistics and distribution. Finally, its development implies the production and reproduction of items in quantities that have grown considerably as the market has grown.

However, the exact contours of the industry are difficult to outline. If we define a sector as all of the companies that have the same main activity or that fulfil the same consumer need by supplying the same market, it is difficult to constitute a coherent statistical whole. In terms of activity, the high level of differentiation in the range proposed by luxury companies and the diversity of the business models encountered undermine an approach based on the substitutable character of the available offer[9]. In market terms, the notion of identical needs disappears faced with the importance of representation: the immaterial wins out over the functional utility of the luxury product. Ultimately, the players themselves are the best placed to define what constitutes luxury: a company belongs to the luxury sector once other luxury companies designate it as the competition[10].

The Originality of an Extremely Differentiated Offer

The first characteristic of luxury companies is the level of differentiation of their products, through branding but also through more subtle methods of prompting the immediate identification of their products as analysed by Jean-Marie Floch[11]. This brand "vocabulary" that builds up over time constitutes the real, immaterial asset of these companies. Commercial success relies entirely on understanding and respecting this asset.

The three levers of differentiation are creative input or design, the specific crafts and skills acquired by companies and the innovations they introduce at any given time. First of all, design is the basic foundation of any differentiated offer. Investment in design is seen first of all through the multiplication of collections: in addition to the traditional Autumn-Winter and Spring-Summer collections we now have pre-collections which have significantly grown in size and between season collections (resort, cruise…), to which we can also add, in some cases, men's collections or haute couture. Some fashion houses produce up to eight seasons annually. As Roland Barthes wrote in the introduction to *Système de la mode*[12], "to capture the buyer's accounting conscience, one must create a veil of images, meaning, reasons in front of the object, to elaborate a mediate substance around it, like an aperitif, in short to create a simulacra of the real object, by substituting the weighted time of wear and tear with a sovereign time that is free to destroy itself by an act of annual potlatch". Luxury companies incontestably carry out the practices of the fashion sector in creating "this unconscious that is constituted with desire as its goal". At the same time, it is clear that many forms, whether it be Christian Dior's "*tailleur bar*" or a Hermès bag, are part of the collective memory and enable companies to claim a certain permanence in their design thus ensuring that they are not associated with the world of throwaway fashion and can claim their rightful place in the timeless universe of luxury. In addition, skill and craftsmanship and the artistic professions are some of the aspects most valorised by these companies in as much as they create a connection between the company's history and its current activity. Whether they come from a saddle-making, handmade shoes or couture background, companies systematically highlight their connection to a noble profession, trumpeting the way they have mastered the most complex craftsmanship. Companies with a high level of legitimacy in terms of craftsmanship thus feel the need to renew their established skills by collaborating with fashion designers.

Finally, innovation also enables differentiation. This can take on various forms whether it means honing new techniques, such as in high-end jewellery, using new fabrics (new textiles) or adapting products to the changes in living habits (Louis Vuitton replacing their trunks with raised lids with flat trunks, Chanel's stark garments or the way Yves Saint Laurent borrowed from menswear to accompany women's liberation…). These three sources tend to increasingly cross over and play off one another to attract consumers.

Haute couture and high quality craftsmanship are the two main professions behind contemporary luxury companies, and they have resulted in different business models. The companies who have their origins in craftsmanship have, in general, a profitable core profession, whether this is leather goods or jewellery for example. This means their diversification is explained by a new valorisation of their skills (jewellery and watch frames, leather work and shoes…). We can also note that certain luxury brands

that come from a craftsmanship background remain specialists in their original trade: this is the case for most watchmakers. The diversification of leather goods companies into ready-to-wear whether it be recent, (Louis Vuitton in 1997) or well established, (Hermès did so before the Second World War) tends to follow a logic of establishing a global brand rather than fulfilling a need for economic balance. The brand then becomes an "editor, a studio, a symbolic operator of the validation of the meaning associated with the product"[13]. It proposes "editorial choices" but can only do so "in a field where it has proven legitimacy". "Brands are a chance to make economies of scale that enable multiple experiences to be categorised under one name".

The more financially fragile fashion houses with their origins in haute couture went looking for complementary activities early on: in perfume as early as the inter-war years, then in licensing contracts and today in accessories. Tomoko Okawa[14] notes that in the seventies, the couture and ready-to-wear activities at Christian Dior were in deficit and were held up by the sales of accessories and licences. More recently, licencing has become rarer and is usually reserved for activities that involve specific skills (perfumes, glasses…). Leather goods, shoes and accessories have acted as internal growth mechanisms that have ensured their development. The share of ready-to-wear in terms of turnover is often down, and smaller than that of accessories.

The Originality of Vertical Integration

One of the main changes to have had a huge effect on the luxury industry is vertical integration which enables companies to control their offer, from the design phase to the point of sale. This movement went against the disintegration trend of the past thirty years with the globalisation of the economy[15]. While they were originally concentrated on the design and production in short series, companies progressively gained market power over their suppliers and developed direct sales through a network of self-owned stores. To begin with, in terms of production, a growing number of luxury firms got involved in the control of their supply chain, both directly and indirectly. In France for example, Louis Vuitton, Hermès and Chanel have invested in production units often located in France or have bought out some of their suppliers. This integration process is particularly obvious in leather goods where the high growth levels and profit margins have reassured companies in terms of their manufacturing commitments. Certain players have also invested in shoe production outfits in Italy, but also in France such as J.M. Weston in Limoges. In addition, the existence of production bottle necks such as the one in leather tanning has led Hermès and Louis Vuitton to buy tanneries to ensure their supply.

In ready-to-wear, integration is less common in France, but quite frequent in Italy. There are a number of reasons for delegating this type of manufacturing to sub-contractors. So French companies, unlike a number of Italian ready-to-wear companies, are rarely directly involved in the production end of things. Their history does not encourage them to take on this role in as much as some have built up close, long-term relationships with some of their sub-contractors even though relationship between brands and sub-contractors are not always easy. The need to regularly supply the production outfit while sales of garments are more and more marked by seasonality and are experiencing a low level of growth compared to accessories has discouraged companies from investing upstream in the supply chain.

The second change concerns the integration of retail by a number of luxury companies. The advantages of direct control are legion: the accumulation of profit mar-

gins as manufacturer, wholesaler and retailer; more brand image coherence; direct contact with customers and very valuable feedback.

It is important to note that the specialist professions of each company do play a part: the leather goods people are mainly retailers while those who come from fashion still use external wholesalers. Watch companies are mainly wholesalers while jewellers distribute most of their products through their own retail network.

However, all companies do not have the means or the vocation to become retailers. They then tend, if they are going through external clients (department stores, multi-brand boutiques), to implement a certain number of vertical restrictions so that the retailer ensures the best possible sale conditions for their products. This can take on different forms including a selection of approved distributors and predefining the range (in quantity and quality) to ensure the best level of visibility possible for the brand at the point of sale. This strategy can be analysed via the theory of the agency. According to Olivier Bomsel, these restrictions enable them to avoid opportunistic behaviour on the part of retailers who might be tempted to push the sale of products which provide a bigger profit margin for them or take a lower level of investment to convince clients.

Company	Number of stores (2010)	% of retail in turnover
Louis Vuitton	452	over 90 %
Gucci	317*	73 %
Hermès	193*	84 %
Bottega Veneta	148*	85 %
Prada	207*	71 %
Salvarore Ferragamo	312*	69 %
Armani	130	68 %
Burberry	417	64 %
Christian Dior	240	81 %
Yves Saint Laurent	78*	55 %

Source: Annual reports of the companies listed.
* branches only

The Originality of the Significance of Representation and the Immaterial

These objective elements of differentiation are combined with more subjective aspects that are essential to the luxury sector. The valorisation of their history, meaning their heritage, the storytelling behind this, the way products are presented in the point of sale and the location of the stores are some of the levers for added value used by luxury companies. Through a series of signals, that can be real or implied, companies manufacture consent to pay more and consumers comply. This is linked to the nature of "positional" object of luxury that represents the psychological or social aspirations of the consumer.

Bernard Catry[17] has examined the different forms of rarity among luxury products. Natural rarity linked to a penury of production factors is combined with techno-rarity created by the marketing of an innovative product, different types of limited editions or when a company itself decides to limit the distribution of a product and finally subjective or virtual rarity that is the result of an overall strategy on the part of the company. The latter in fact has a range of elements at its disposal: pricing levels, retail mode, and advertising. It is clear that the retail choices for a product influence its visibility and as such the idea of rarity it represents. The growing level of forward integration of companies and the development of self owned retail networks fulfil this objective to create added value as well as the need to control the spread of the offer.

This determination to develop a perception of rarity has consequences on the choices in terms of the value chain and consequently on business models.

The Originality of the Acceleration of Globalisation

Globalisation is not new in the luxury business. On the one hand, the small size of the national market makes it essential to develop business on a worldwide scale; on the other, while it is very difficult to export products that do not stand out as their equivalent is available in other countries, exceptional products with strong identities are attractive to consumers all over the globe.

Patrick Verley[18] notes that in the 19th century, where exports were out of the question due to transport costs, only products that benefited from a price-elasticity had a positive demand. This was the case for luxury products. He adds that between export and import countries, the perception of the quality of the products never coincided: an imported product that was considered distinguished was only rarely seen to be a luxury product in its own country. Conquering international markets became one of the major characteristics of luxury companies.

This development has, of course, taken on different forms according to the periods in question. The rise in the standard of living in the different continents over the past two decades has profoundly modified the cartography of the luxury market. In addition, the accelerated globalisation process has worked in favour of the international development of luxury firms. In a closed economic context, where exports were hindered and setting up office abroad was difficult, companies tended to delegate to licence holders for distribution but also for the manufacture of their products. Newly open markets enabled companies to take back control of their activities in most regions, by direct investment, thus enabling the establishment of a coherent brand image and offer all over the world.

Until the end of the seventies, the United States and Europe constituted the main international markets for luxury companies. Japan's economic catch-up after the Second World War and in particular the taste of the Japanese for western products made the archipelago a key location for growth at the end of the seventies up until the Asian economic crisis at the end of the nineties. Since then its relative position in worldwide terms has diminished to a great extent due to the rapid development in other geographical zones. The ex-communist countries (Russia and Eastern Europe), the Asian dragons and other emerging economies (China, Latin America…) have taken over a growing share of sales by luxury companies. The progressive opening up of markets as well as the emergence of a middle class in these countries are the signs of a dynamic that continues to grow.

Geographical zones and turnover share (2010)

Company/ Group	Europe	Americas	Japan	Asia (but Japan)	Rest of the world	Total
LVMH – Fashion & leather goods	29 %	18 %	16 %	30 %	7 %	100 %
Hermès	38 %	16 %	19 %	26 %	1 %	100 %
Gucci	30 %	18 %	12 %	36 %	4 %	100 %
Bottega Veneta	26 %	16 %	24 %	31 %	3 %	100 %
Bulgari	35 %	13 %	19 %	27 %	7 %	100 %
Yves Saint Laurent	48 %	22 %	9 %	13 %	8 %	100 %
Prada	40 %	16 %	10 %	33 %	1 %	100 %
Salvatore Ferragamo	23 %	22 %	16 %	34 %	4 %	100 %

Source: Annual reports of companies listed.

In conclusion, the characteristics we have covered briefly show that the luxury business displays a rare combination of fierce competition and of monopolies of varying lengths in Edward Chamberlin's view[19]. The keys to success come from creativity

and innovation, both of which constitute the ultimate boosts in firm's differentiation policies that enable them to establish their market position.

This situation is all the more favourable as some studies show that coming up to 2025, the luxury market may reach 1000 billion dollars[20]. This perspective, that is by no mean a forecast, is based on the growth of emerging markets (as they are responsible for two thirds of the anticipated growth), but also a higher level of urbanisation in the world, not forgetting the growth potential of a number of product categories (products for men, leather goods and shoes…).

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1. Y. Moulier Boutang, *Le Capitalisme cognitif. La nouvelle grande transformation*, Paris, Éditions Amsterdam, coll. Multitudes/Idées, 2007.
2. O. Bomsel, *L'Économie immatérielle. Industries et marchés d'expériences*, Paris, Gallimard, 2010.
3. Montesquieu in *Lettres Persanes* ; Mandeville in *La Fable des abeilles* ; Voltaire in *Lettres philosophiques* (on trade) ; Saint-Lambert, in "luxe", an article for the *Encyclopédie*.
4. H. Baudrillart, *Histoire du luxe privé et public, depuis l'Antiquité jusqu'à nos jours,* Paris, Hachette, 1880.
5. Ch. Gide, *Cours d'économie politique*, t. 2, livre IV, Paris, Librairie de la Société du Recueil Sirey, 1919.
6. 7th press conference from the Président de la République (September 21st 1972), source: INA.
7. Source: Altagamma 2010 Worldwide Markets Monitor. This study covers fashion accessories (leather goods, shoes, watches, jewellery) perfumes and cosmetics and tableware.
8. A number of writers use the term fashion: ready-to-wear is more appropriate as leather goods and especially shoes are also subject to fashion.
9. In economic theory, two companies that belong to the same sector of activity have either a high level of crossover in their offer, which means that their production techniques are similar, or a high level of crossover in their demand, which means that their products are interchangeable in the eyes of the consumer.
10. This is the approach chosen by O. Bomsel, E. Fieffé-Prévost et P. N. Giraud, *L'Industrie du luxe dans l'économie française*, CERNA-Ecole nationale supérieure des Mines de Paris, 1995.
11. J. M. Floch, *L'Indémodable total look de Chanel*, Paris, IFM-Regard, 2004 ; *Identités visuelles*, Paris, PUF, 2010 (réed.).
12. R. Barthes, *Système de la mode*, Paris, Seuil, 1967.
13. This and following quotes from O. Bomsel, *op. cit.*, 2010.
14. T. Okawa, « La maison Christian Dior, modèle de référence pour les années 1960 », in *La Mode des sixties*, Paris, Éditions Autrement, 2007.
15. On the subject of the links between globalisation and the vertical disintegration of companies see J. McLaren, "Globalization and Vertical Structure", *American Economic Review*, vol. 90, n° 5, December 2000.
16. For a more in-depth analysis on brand discourse and in particular an analysis of Chanel, Christian Dior and Yves Saint Laurent, see Bruno Remaury, *Brands and Narratives. Brands and the Cultural Collective Unconscious*, Paris, IFM-Regard, 2004.
17. B. Catry, « Le luxe peut être cher, mais est-il toujours rare ? », *Revue Française de Gestion*, n° 171, Lavoisier, 2007.
18. P. Verley, « Marchés des produits de luxe et division internationale du travail (XIXe-XXe siècles) », *Revue de synthèse*, 2006/2.
19. E. Chamberlin, *Theory of Monopolistic Competition*, 1933.
20. Goldman Sachs, *A Trillion Dollar Global Industry by 2025?*, June 2010. This study includes the wines and spirits market.