How strong is the pricing power of luxury goods

An outlook on how short- and long-term price inflation will impact core pillars of the luxury industry

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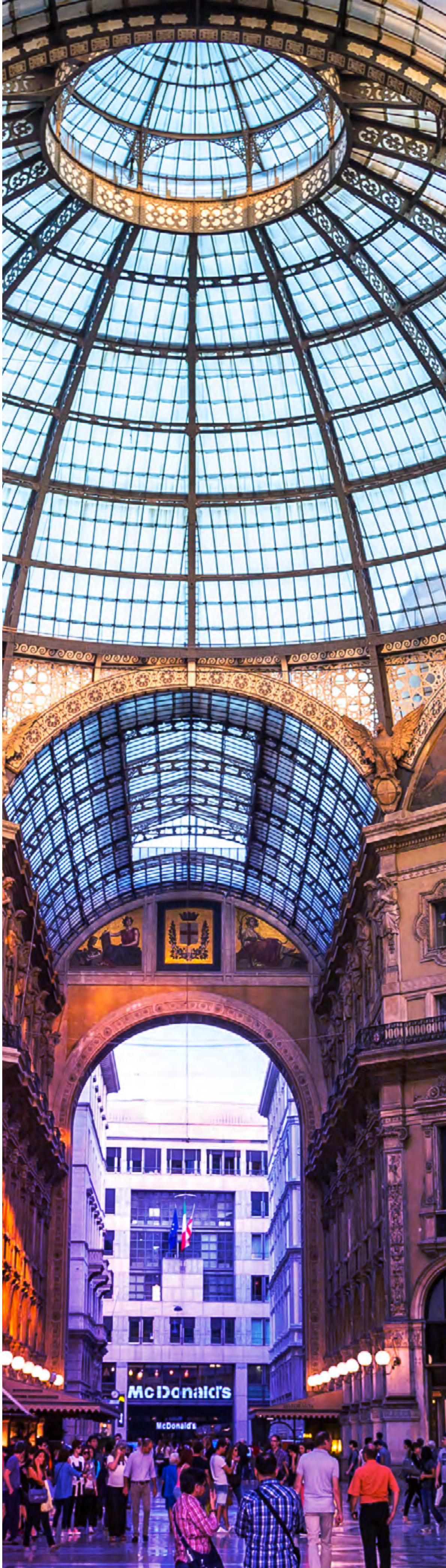
Foreword



The luxury industry typically performs better than other sectors during an economic downturn. However, with the current developments in the global economy and consumer spending behaviors, the question is not if but rather when the luxury industry will face the adversity headwinds.

This report assesses seven pillars of the luxury industry based on short- and long-term outlooks on price inflation, and highlights business functions that are anticipated to play an important role in combatting the economic downturn in the industry:

- **Global economy**
- **Demand elasticity**
- **Price and desire relationship**
- **Efficiency of seasonal pricing strategies**
- **Development of Chinese consumer behavior**
- **New consumer behavior**
- **Entry level luxury goods**

For this research, we analyzed primary and secondary data. To gain further insights into the dynamics of the industry, we also interviewed Raffi Balyozyan – Investment Advisor, Luxury Goods at Genthod Global Wealth Management, the investment advisory division of Swiss luxury group Franck Muller, and Benjamin Voyer, Cartier Chair Professor and Professor of Behavioral Science at ESCP Business School.

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Investment Advisor, Luxury Goods, Genthod Global Wealth Management

Key Findings

01 **The effects of global inflation shouldn't be generalized nor extrapolated within the luxury sector.** Although consumers appear willing to pay increased prices for luxury goods at the moment, the dynamics of the global economy indicate that inflation will remain high although moderate. This may present new challenges for luxury brands.

02 **Price plays a different role for different consumer segments.** Inelastic demand rests with selected luxury brands that hold a strong position in the economy, whose consumers are emotionally connected with the brand.

03 **The power of a high price to drive desire is decreasing** as consumer behavior is shaped by trends such as sustainability and investing. Further, technology offers the consumer means and incentives to satisfy their desires in various ways, making luxury goods more and more interchangeable.

04 **The efficiency of seasonal price tactics is challenged** by the quest for more efficient management of the cost of capital and environmental regulations. Luxury brands need to optimize their operations and have a better understanding of the shopping behavior of their consumers.

05 **The Chinese consumer increasingly considers price in decision making** and seeks price transparency. Chinese luxury brands are on the rise as they are associated with a higher value for money. Chinese travelers typically look for tax relief, and can therefore be considered price sensitive (Voyer).

06 **Millennials' purchase power is rising, however they have been through multiple crises and now seek stability.** If inflation continues, impulse purchases might decrease. While Gen Z enjoys experiences over physical things, the impact of the current crises on their purchase behavior is yet to be seen.

07 **Entry-level luxury goods should not outprice the aspirational consumer.** To help make entry-level goods successful, brands need consumers that will buy and an audience that will recognize the brand. A price that is too high could make this impossible.

07 **Luxury brands can focus on:**

a. Consumer insights that support driving brand desire
b. Pricing strategies and technologies that balance price transparency and product exclusivity across channels
c. Product portfolio management and planning to ensure optimal performance of the capital
d. Omni-channel solutions that make technology part of the value delivered by the luxury brand

01

The inflation game in the global economy

Key takeaways

- Luxury goods companies can be considered inflation-proof as the consumer is willing to pay the increased price. However, in the long term this strong standing might be challenged.
- The high-end luxury market and major luxury brands are less affected by inflation than the rest of the market.
- Luxury companies need to develop a broader view of the macro- and micro-economic dynamics.

A glance at the current inflation scenario

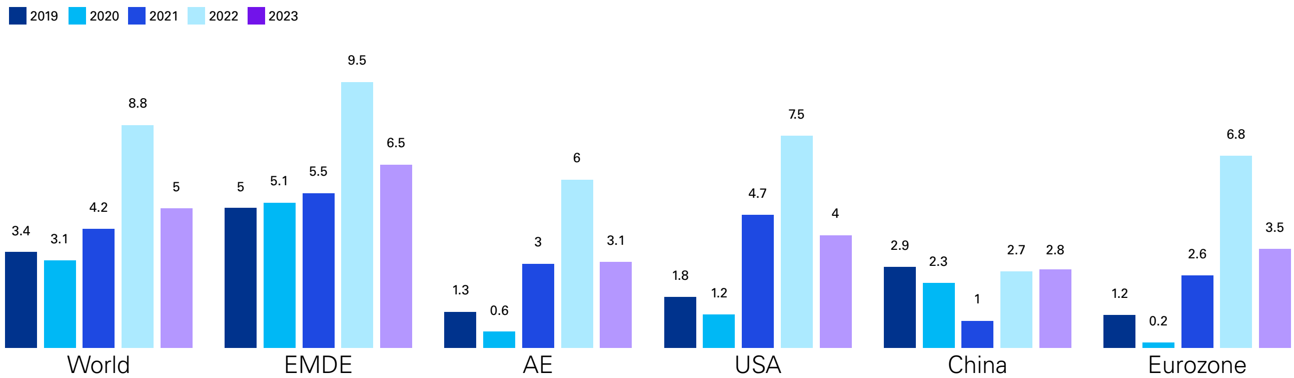
Global inflation, which initially surged in early 2021, continues to remain high even after 18 months. Supply chain disruptions adjoined the situation, creating a more tenacious and persistent inflationary pressure than initially expected by global central banks, who believed the price surge was a temporary side effect of the recovery.

For nearly half of advanced economies and 72 percent of developing countries, the 12-month inflation rate (through December 2021) exceeded 5 percent.[1] To put this in perspective, this is 1.2 percentage points higher than the average annual global inflation of 3.8 percent recorded between2001 and 2019 period.[2]

Additionally, advanced nations witnessed increased costs of fuel and electricity, which ultimately contributed to the rise of consumer pricing. For developing nations, the rise in raw material prices due to current geopolitical tensions and an increase in demand for goods from other parts of the world were among the foremost reasons driving inflationary pressures.

Global inflation is forecast to rise from 4.7 percent in 2021 to **8.8 percent** in 2022. However, central banks across the world are raising their interest rates in an effort to reduce the inflation rate and expect a decline of inflation to 6.5 percent in 2023 and to 4.1 percent by 2024.[3]

Global inflation baseline forecast, 2019–23[4]



Note: EMDE = Emerging Markets and Developing Economies, AE = Advanced Economies
(Source: [Global Inflation Baseline Forecast, 2019-2023], [Justinas Liuima, Euromonitor], [June/2022])

Continuous price surge signaling inflation in the global luxury industry

Luxury goods companies continue to face challenges that lead to price increase. Due to the global economic collapse brought on by lockdown restrictions, plant closures, and supply chain disruptions caused by the pandemic, in 2020 sales for luxury goods fell year over year by 18 percent.[5] To make up for these losses, luxury brands hiked prices by almost 17 percent[6] in 2020 and in early 2021, higher than the annual price increase of 5 to 10 percent[7] expected by luxury shoppers.

While these setbacks affected the luxury goods market, it bounced back quickly in 2021 to pre-COVID-19 heights as the purchasing power of the consumer was strengthened by higher savings during lockdown. This also induced luxury companies to increase their prices.

The price surge taking place now is outpacing annual inflation. For instance, women's handbags saw the highest price surge of 22 percent from 2019 to 2022. Woven items such as T–shirts are also 15 to 55 percent[8] more expensive than they were in 2019.

Drivers of inflation in luxury goods market

The primary drivers of inflation vary among nations, especially when comparing advanced and developing economies. However, we believe the following trends are having the biggest impact on the luxury sector.

Ongoing supply chain crisis – Luxury goods are produced through intricate supply chains. Since the early stages of the pandemic, supply chain bottlenecks have piled up globally, severely limiting the ability of supply networks to make deliveries on time in the luxury goods market. Further, pent-up demand during the recovery phase, along with trade and production disruptions in Russia and Ukraine, put additional strain on supply networks, which resulted in an ongoing supply chain crisis. Ideally, supply shocks are expected to be temporary and tend to have a passing effect on prices. When supplies return to normal, it's likely prices will as well. However, since the supply shocks have sustained for a prolonged period, the luxury goods market is experiencing further price inflation pressure.

Soaring energy costs – The conflict in Ukraine roiled energy markets worldwide, especially in Europe. This affected all markets for goods and services, including luxury goods. The conflict also led to sanctions prohibiting oil imports from Russia, which drove energy prices higher. For instance, in June 2022, Brent oil prices rose by about 68 percent[10] compared to 2021, while TTF gas prices in Europe spiked to a record high of US$191.7[11] (EUR192[12]). As a result, all commodity prices, including raw materials used by the luxury goods market such as cotton, gold and silver, rose in line with the surge in energy prices. This led to an increase in production cost, added pressure to the profit margins of luxury businesses, and resulted in one of the prominent causes of the current price inflation.

In the first five months of 2022, the average price of luxury goods was 25 and 7 percent more expensive than in 2019 and 2020, respectively.[9]

Both Benjamin Voyer and Raffi Balyozyan agreed that they do not perceive a problem with the present price increase. Balyozyan further pointed out that luxury has been very resilient and has recovered well after the past economic downturns and crises.

Recently, several major luxury groups and houses announced an increase in global prices of their luxury goods. However, that did not seem to deter the consumers, at least not in the short term. The year-to-date results for the 2022 calendar year suggest that the luxury goods consumer is willing to pay the increased price. In the current view, luxury prices appear resilient to inflation. The main pillars of this resilience are access to the high-income consumer, luxury goods having the perception of investment material and the reversed relationship between the price and the demand typical for this sector.

Despite this strong status of luxury, both experts agreed that this formula holds true for the high-end luxury and major luxury brands. From an economic behavior standpoint, the mainstream luxury market tends to be more affected by inflation than the high-end luxury goods market.

The prices are rising with little indication of change and we anticipate that luxury goods companies will need to increase not only their efficiency, but also their resilience against unfavorable global economic dynamics.

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02

Determining the elasticity of demand in luxury goods

Key takeaways

- The effects of (price) inflation shouldn't be generalized. Price plays a different role for different consumer segments of luxury goods.
- The divergence between the consumers of high-end luxury and mainstream consumers is increasing.
- Even wealthy consumers are taking notice of price increases.

Elasticity of demand for luxury goods can be analyzed as a function of two parameters – income and price. In terms of income, luxury goods typically show high-income elasticity of demand. As income levels rise, conspicuous consumption does too.

However, price plays a different role for different consumer segments. Typically, entry-level luxury goods display high elasticity in demand. This is owing to the fact that when the price of a luxury product becomes too high, the consumer tends to defer rather than forgo the purchase.[13] This tendency is shown up to a price threshold, beyond which, this consumer group starts perceiving that the companies are unfairly raising the prices above the acceptable price range. This cohort of consumers (even though they have the income to pay for the inflated price) might decide to forgo the purchase entirely or opt for a substitute.[22]

Unlike entry-level luxury goods, demand for higher-end luxury goods has a more inelastic demand curve. For the affluent consumers, the price of luxury goods (particularly high-end luxury goods) remains inelastic to an extent. As for this group of buyers, price does not hold much importance when buying and is only considered to determine if a product is luxurious or not.

The leverage to continuously raise prices rests with selected luxury brands that hold a very strong position in the economy, whose consumers are emotionally connected with the brand and are willing to pay increased prices for their purchases.

This group (characterized by lower price sensitivity) prefers the price of luxury goods to be high (as that helps them feel elite, exclusive and at the high end of the social strata). Hence when the price of luxury goods rises, their demand does not suffer.[14, 15, 16, 17]

- During the 2008–2009 recession, high-end brands such as Louis Vuitton didn't offer discounts, but instead hiked prices on average of 12 percent. However, despite the price hike, profits from Louis Vuitton's fashion and leather goods rose from US$812.8 million (EUR814 million) in June 2007 to US$917.6 million (EUR919 million) in June 2009.[18]
- Similarly, in 2022, when the price of some of LVMH's popular handbags grew by about 20 percent, consumers continued to buy the product. Driven by the growing demand, the fashion label announced the introduction of two new production sites by the end of 2022.[19,20,21]

The mainstream and entry-level luxury consumer will eventually say 'enough' to price increases.

"Generally speaking," Voyer stated, "luxury goods are extremely resilient. They are seen as investment grade material that defy price elasticity. However, increasingly there is a divergence between the highest end of the market and the more mainstream part of the market."

Voyer and Balyozyan agreed that luxury brands must not increase the prices too much, even though these products can be hard to find. Voyer pointed out that excessive price increases without justification can nudge consumers towards substitutes.

"I do think that luxury goods have some room to play with, but I also think that they need to be aware of the danger of increasing prices too much. It works like a magnet. You want to keep on dragging people by being at a reasonable distance at which the magnet can still function. There is a risk that if you go too far, the magnet stops," stated Voyer.

It is crucial to take into account the different consumer categories when analyzing how macro-economic issues will affect the luxury market. Luxury is a broad term with ambiguous definitions. High-end luxury is different from mainstream and entry-level luxury, hence the effects of inflation shouldn't be generalized. Moreover, as Voyer stated, "this time we've got the once in a century health crisis, the pandemic, coupled with the geopolitical constraints and uncertainties of environment and more financial crisis potentially looming", which further evokes the question of the consumer's willingness to buy.

Wealthy consumers notice price increases.

The wealthy and ultra-wealthy, although they are not worried about inflation, still demand price justification that translates into a demand of exclusivity and quality excellence. Moreover, Voyer added that "it's biased to think that consumers always consume accordingly to their level of wealth. There is less and less of the stereotypical luxury consumer."

It seems that at least the mainstream companies need to be careful. "Ultimately, even luxury goods consumers do have price points and if the situation continues worsening, they will reconsider their purchase," concluded Voyer.

03

Drawing parallels between price increase and desire

Key takeaways

- To maintain exclusivity during periods of inflation, the price of luxury items is expected to increase.
- However, the power of high price to drive desire is decreasing.
- Moreover, technology offers consumers means and incentives to satisfy their desires in various ways making luxury and premium goods more and more interchangeable.

Luxury goods have often been observed to display a Veblen effect (wherein the demand of a good rises with an increase in price). As per this effect, consumer behavior is not driven by the want to satisfy subsistence needs, but by other factors.[23, 24, 25, 26]

01 Desire for seeking status

Status seeking as a construct refers to a motivation that encourages individuals to improve their social image via conspicuous consumption of consumer goods that symbolize status.

- Here, consumption behavior is directed by the desire to gain respect, group membership, recognition, and distinction.
- Thus, as the price of a commodity rises, consumers seem to derive higher utility predominantly because they have paid a high price for a product.

02 Need for uniqueness

The market of luxuries is based on the concept of scarcity, which is used to create the idea of uniqueness in the minds of the consumer. According to this ideology, as the price of a luxury good increases, fewer people can afford it.

- The high price of a product signals the thought of scarcity and thereby appeals to an elite segment of consumers.

03 Vanity in individuals

Vanity in individuals can propel consumption of luxury goods, as luxuries can be used as a manifestation of achievement and physical appearance.

- Some choose to consume luxury goods and pay a higher price as they draw and relate the utility of the price point to their social image.
- These consumers derive satisfaction from their physical appearance and experience a positive audience reaction in consuming luxury products.

It can be said that consumers of Veblen goods would typically show a higher propensity to increase their consumption with a rise in prices.

Desirability and uniqueness can help drive demand for luxury goods

Desirability and exclusivity have always been the not-so-secret part of success in luxury. In times of inflation, luxury companies are not only challenged by potentially shrinking margins, but also by keeping the price at the heights where it communicates the exclusivity to drive desire while balancing the volume that is required in mainstream luxury. "Mainstream consumers have a price point in their mind, and luxury companies might soon be dealing with a price ceiling," said Voyer.

Furthermore, luxury brands also need to keep fulfilling what desire for status, uniqueness, and vanity means to today's consumer, and a high price might not be the sole solution. If companies increase prices, it can not only impact the exclusivity but, also affect the middle-class. "Mainstream luxury brands need to maintain their focus on growth while improving operating margins. Shortsighted decisions could severely impact demand, specifically the demand of the middle class," stated Balyozyan.

To conclude, Voyer stated that it should not be forgotten that a luxury product is more substitutable than it looks. When buying a new luxury product, consumers are looking to treat themselves. "Today, we are constantly presented, particularly through social media, with more things to desire."

Technological advancements can help drive the interchangeability of luxury goods

Traditional luxury is becoming more and more interchangeable. Today, technology allows us to desire more and differently. Luxury companies know that technology is the next stage to achieve further growth. It's creating both opportunities and constraints because luxury companies are increasingly competing with companies that offer value to the consumer in different ways, noted Voyer.

However, when considering immaterial luxury in the virtual space, such as the metaverse, Voyer continued: "I'm skeptical that the virtual world will work on anything but an 'all-you-can-eat' format." He explained this with the example of music, where streaming endless music catalogues becomes more important than owning a few songs.

Balyozyan highlighted that consumers dealt with price increases following merchandise scarcity in the primary market due to COVID-19 disruptions. The secondary market was bolstered by the emergence of luxury e-commerce platforms as well as certified pre-owned websites.

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Here, the difference is between mainstream and high-end luxury and companies must be very smart in the pricing strategies as they play an important role.

Consumer behaviors should not be presumed

While we discuss implications of consumer behavior changes in section six, it is important to point out here that when luxury companies continue hiking prices, they can involuntarily nudge their consumers into alternate ways to buy into the luxury landscape. As Voyer pointed out, this should not be undermined because often it's when you have constraints that your consumer thinks out of the box.

When prices for luxury items increase drastically or an item is not available, consumers look for two alternatives. First, they may look for the item they desire in another market. Secondly, they may find something else that meets their need for uniqueness.

04

Discounting as a subtle pricing strategy for luxury goods

Key takeaways

- The efficiency of various discounting strategies applied by mainstream and premium luxury companies is decreasing.
- Environmental regulations and management of the cost of capital are strong motivators to optimize planning and merchandising processes.
- Operational efficiency and the importance of consumer data is increasing in the luxury sector.

Discounting in the luxury industry, particularly in high-end luxury, isn't considered appropriate. However, when looking closer into the behavior of various consumer segments and luxury brands, discounting isn't completely uncommon.

As mentioned in section two, an elite segment of consumers consider a product's price as a criterion to determine its quality, scarcity, and exclusivity. These consumer segments are often interested in collectibles that are rare and are willing to pay an increased price whether in primary or secondary markets.[27, 28]

Mainstream luxury goods consumers are willing to buy luxury items even for increased prices, but they are also consumers of outlets and seek discounts.

Furthermore, there are consumers who are just affluent enough to purchase an entry-level luxury good and desire discounts even stronger than higher earners. According to the YouGov Affluent Perspective's Global Luxury Retail Report 2018, about half of all global consumers of luxury goods stated that they tend to buy luxury goods only when they are discounted.[29] A similar pattern was observed in 2020 as a result of COVID-19's impact on consumer spending.[30]

Further, there exists another consumer segment in the luxury goods market that associates price with quality and brand image, yet tends to wait for price reductions or promotional discounts to make the purchases. This is a mixture of groups that include the high-earning-not-rich-yet Millennials and Gen Z, some members from affluent households, and mid-tier consumers. To cater to the needs of this consumer base, luxury brands tend to adopt several discreet discounting strategies where, instead of upfront discounts, reduced prices are provided via private sales, exclusive memberships, and personalized promotions.

Mainstream and premium luxury businesses adjust their prices both upward and downward to address consumer demands and stock levels. To retain the interval within which the price can vary and still sustain the necessary margin, luxury companies are working to improve their operational efficiency, particularly in light of the recent supply issue and rising prices discussed in section one of this report.

Price strategies and operational efficiencies

Mainstream luxury outlets often play an important role to ease the stocks of the leftovers without diluting the brand. One of the ways to prevent struggling with pricing and overloaded outlets and diminished value is to have the right level of merchandise produced, shipped, and stocked in the stores. Data science plays an important role in helping companies forecast and optimize the cost of capital. "Today I still see a reactive response rather than planning when it comes to the pricing strategy of luxury brands. This can be explained by the lack of visibility regarding the economic cycle," mentioned Balyozyan.

According to Voyer, "Luxury companies are trying to identify the true willingness to pay and the true willingness to buy." The need to optimize merchandising plans can be crucial to not only keep the rich margins, but also stay compliant with stringent environmental regulations.

High-end luxury is not concerned about margins or overstocked outlets. The high demand for their brand and business model doesn't push them toward gaining a better understanding of their consumers. However, these luxury goods companies are striving to improve their back office. It seems that companies are aware of the need to be updated to face the challenging markets, new forms of competition and increasing war for talent.

05

Understanding the relationship between pricing and Chinese consumers' purchase intentions

Key takeaways

- Brand recognition is an important decision-making factor and a driver of mainstream luxury that is price sensitive.
- The rise of Chinese luxury brands is stirring the price game as they are associated with higher value for money.
- Chinese travellers are seeking tax relief, and can be considered price sensitive (Voyer).
- Chinese consumers are looking for price transparency (Voyer).

High disposable income and desire for social recognition drive demand for luxury goods

Chinese consumers are known for their strong appetite for luxury purchases, as evidenced by the share of 32 percent[31] held by the Chinese market in the global luxury goods industry in 2020. According to Euromonitor International[32], the country is expected to surpass the US to become the world's largest market by 2025. Growth in China's luxury market is primarily spurred by the country's burgeoning income levels[33] and middle-class consumption. According to the World Bank, it is estimated that by 2030, nearly 70 percent of China's population could consist of the middle class, which could consume goods and services worth nearly US$10 trillion (of the expected global middle-class consumption of US$64 trillion)[34]. This implies that more people have the disposable income to spend on items such as luxury goods.

According to Balyozyan, Chinese consumers see luxury goods as an important vehicle of social status and prestige. While the exclusivity and rareness of the goods remain important purchase drivers for the wealthy, brand recognition plays an important role in the middle-class consumer segment and often ranks higher than quality and craftsmanship as a decision-making factor.

Balyozyan seconded the importance of status and prestige that Chinese consumers seek to project via the purchase of luxury goods. He further added: "Deep down Chinese consumers want European brands with a strong international reputation."

Response of Chinese consumers to the rise in prices of luxury goods

Chinese consumers tend to respond similarly to price increases as global consumers, though in both cases it depends on the consumer segment. In 2021, there were nearly 1.535 million households in China in the elite category of luxury goods consumers.[36] These are observed to remain not significantly affected by the price surge.[37]

In 2021, China ranked 4th highest by high net worth population with annual growth 5%, after the US, Japan, and Germany.[35]

The consumers of mainstream luxury goods in China are believed to be more price sensitive and have a price threshold beyond which any increase in the price of luxury commodities leads to a dip in the demand (Voyer). Therefore, in such cases, luxury brands have limited power to raise their prices without impacting their demand.

Yet some sectors of luxury are challenged not only by the price sensitivity of mainstream luxury consumer but also by new players rising in the local market which are stirring the price game as they are associated with higher value for money.[39,40]

Voyer points out that, "although currently it is believed by the industry that Chinese consumers buy from Western companies because there is a distrust in Chinese luxury products, with regards to jewelry, it is the Chinese jewelry companies that dominate the luxury jewelry segment in China." "The market is gaining its attractiveness but not necessarily only for the traditional luxury brands", further stated Voyer. Behavior of uprising consumers is further developed in section six.

Price sensitivity of the Chinese traveling consumer

In the context of price increase, it is important to consider the Chinese traveling consumer that is typically buying into mainstream luxury. In the past, this consumer segment showed reluctance in purchasing international luxury brands in China due to the high tax.

Today, as the Chinese government has started to realize this gap, several duty-free stores have been introduced in the country which offer luxury products at attractive prices.

This tactic has attracted the interests of Chinese travelers,[41] who now continue to drive growth in the domestic market. However, presuming that this group is not price sensitive would be incorrect.

Average annual personal disposable income per capita in China, from 2010–2021[38]

2010
USD 1,854

2015
USD 3,585

2021
USD 5,550

> **"The local Chinese consumer is different to the traveling Chinese consumer who is predominantly middle-class and comes to the store with a precise wish, knowing what is available for a purchase without waiting lines. They are not prepared to spend lavishly to get on a waiting list."**
>
> **Benjamin Voyer**
> Cartier Chair Professor and Professor at ESCP Business School

The call for price transparency

Balyozyan indicated that the trend in the luxury goods market has shifted towards transparency and parity, and that companies might follow a more balanced price strategy worldwide, rather than taking the advantage of the strong Chinese consumer base by charging high prices.

While companies such as LVMH are working to decrease their dependency on the Chinese market,[42] China remains a greatly profitable and attractive market.

The inflation rate in China is low, the price index is higher compared with Europe, and while companies are working to narrow down the price difference between Paris and Shanghai, the lower operating costs keep adding to the attractiveness of the market, mentioned Balyozyan. Considering the overall situation, the traditional portfolio of luxury companies appears to be happy that the Chinese consumer is increasing the local spend. Profitability of the local market is undoubtedly attractive.

The experts agreed that prestige and status remain the leading demand drivers for luxury goods in China. They also agreed that the behavior of the Chinese consumer is changing, and that price is critical in making purchasing decisions. Given the dynamics, the traditional luxury goods companies might be cautious when addressing price increases in China. "If unjustified, that wouldn't be welcomed in the right way by Chinese consumers", concluded Balyozyan.

The development of the local market in China is further discussed in section six through the lens of the development of a new generation of consumers.

The comfort of traditional global luxury goods companies is further challenged by the consumer's quest for transparency.

06

Studying the behavioral buying traits of a new generation of prominent consumers

Key takeaways

- Millennials' purchasing power is growing. However, the impact of 2008-09 recession and current situation on their spending behavior should not be marginalized.
- The new generation of Chinese consumers is brought up in a strong pro-China environment and is very nationalistic, and that is shaping their buying behavior.
- Price strategies for attracting new generations is becoming more crucial for Western luxury players.

Millennials are one of the largest and fastest-growing consumer bases for the luxury personal goods market.

Millennials accounted for about 35 percent[43] of all expenditures for luxury personal goods in 2019 and are expected to drive luxury growth worldwide by reaching a share of 45 percent[44] by 2025.

However, this generation is becoming more price cautious. The educated middle class, especially the older millennials, haven't yet gotten over the price-conscious tendencies they developed after the 2008 economic meltdown. Furthermore, it is not only the economic turbulence that shaped their shopping behavior.

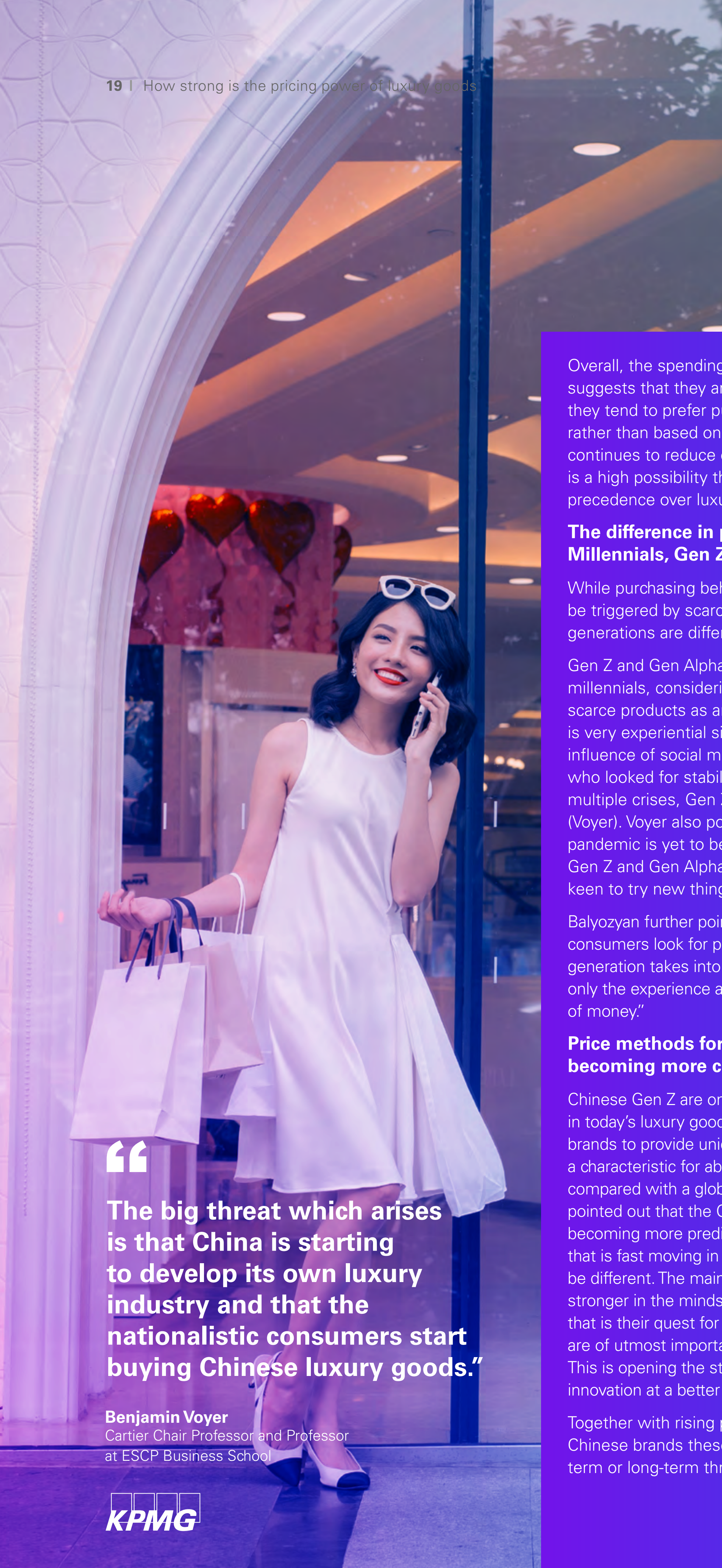
Millennials are expected to prioritize investments in tangible assets and buying necessities over purchasing aspirational items. Inflation, combined with the economic crisis, may have long-term impacts on their purchasing behaviors.

Gen Z spending is also emerging as a crucial growth lever for the luxury sector, and is predicted to account for 15 percent[45] of the worldwide market for luxury personal goods by 2025. Overall, this new generation is ready to spend money on luxury goods, but they spend it differently.

Gen Z luxury shopping habits are identified as social media influenced, brand image affective, and information intensive. They are less interested in merely owning luxury goods. The uniqueness and authenticity of the brands and the opportunity for experimentation help drive the demand of these consumer segments.

Further, Gen Z and Gen Alpha grew up in a digital-first world, and they expect technology to be part of their consumer journey which should allow for a seamless transition between online and offline worlds.

Product quality, durability and environmental impact also factor into their decision-making process. These consumers expect the affluent brands to adhere to the environmental trends and take care of the environmental consequences on behalf of all consumers. If these specific needs are fulfilled, spending more money isn't a barrier for this generation.[46, 47, 48, 49, 50, 51]



> "The big threat which arises is that China is starting to develop its own luxury industry and that the nationalistic consumers start buying Chinese luxury goods."
>
> **Benjamin Voyer**
> Cartier Chair Professor and Professor at ESCP Business School

Overall, the spending behavior of these two generations suggests that they are not entirely price oblivious and they tend to prefer purchases that are thought through rather than based on emotions. Furthermore, as inflation continues to reduce consumer purchasing power, there is a high possibility that making ends meet will likely take precedence over luxury purchases.

The difference in price perception between Millennials, Gen Z, and Gen Alpha

While purchasing behavior of new generations can still be triggered by scarcity and premiumness, the new generations are different to the reigning Millennials.

Gen Z and Gen Alpha see luxury differently than millennials, considering vintage to be luxury and seeing scarce products as an investment, said Voyer. Gen Z is very experiential since they are brought up with the influence of social media; hence, unlike the Millennials who looked for stability because they had been through multiple crises, Gen Z experiments with their investments (Voyer). Voyer also pointed out that the effect of the pandemic is yet to be seen in the long-term behaviors of Gen Z and Gen Alpha, but for now these generations are keen to try new things regarding luxury investments.

Balyozyan further points out that Gen Z luxury goods consumers look for price justifications: "The Gen Z generation takes into account in the buying process not only the experience and emotions but also looks for value of money."

Price methods for attracting new generations becoming more crucial

Chinese Gen Z are one of the most discerning groups in today's luxury goods market, constantly challenging brands to provide unique and authentic products. This is a characteristic for about 70 percent of Chinese Gen Z's, compared with a global average of 50 percent[52]. Voyer pointed out that the Chinese market is maturing and becoming more predictable, but it remains the market that is fast moving in a way that consumers want things to be different. The main game changing behavior is rooted stronger in the minds of the young Chinese consumer – that is their quest for novelty. Innovation and personalization are of utmost importance for the younger consumers. This is opening the stage for local luxury brands that bring innovation at a better price than Western brands.

Together with rising pro-China culture, and response of Chinese brands these factors are starting to pose a mid-term or long-term threat for the Western luxury players.

07

Analyzing the price sensitivity of entry-level luxury goods

Key takeaways

- The importance of entry-level items is increasing to keep the aspirational consumer connected to the rest of the portfolio, which may be subject to price increase.
- Businesses are expanding their selection of entry-level luxurious goods. This can have an impact on portfolio management processes and strategies.
- To help make entry-level goods successful, the brands need consumers that will buy and an audience that will recognize the brand. Too high a price might prevent this exchange to function.

Entry-level luxury goods are designed by luxury brands to entice buyers who are yet unable to afford the brand's high-end products. These goods can be categorized as non-essential consumer goods which are compared with luxury in quality and design, but are less scarce and expensive than the high-end luxury items. To retain the high quality of products, overall brand integrity and the core appeal of luxury, the prices are kept higher compared to other mass-market products.[53, 54]

Consumers who buy entry-level luxury products are of two types. One cohort of consumers includes members from the affluent class who consume these products almost daily. These consumers are more concerned about the quality, less concerned about the price, and like the goods they are buying to embody social status.

Another one is a rapidly growing mass consumer group known as the middle-class consumers, who have limited purchasing power but save money to spend on luxury items. These consumers are fascinated by the luxurious lifestyle of the richer classes and hence look for affordable luxury products. However, in conjunction with their desire for prestige and luxury, price is an important factor for their purchase decisions for luxury items. They have a price threshold beyond which any increase in the price of luxury commodities leads to a dip in demand.

Further, as prevailing inflation continues to reduce consumer purchasing power across the world and luxury brands tend to vigorously increase prices, the consumption of entry-level luxury goods may plummet.

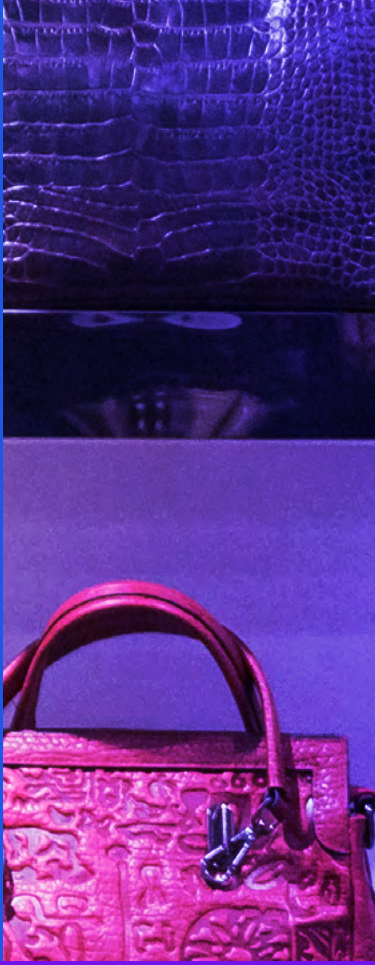
It can be said that the consumers of entry-level luxury goods with limited purchasing power and high responsiveness to price changes demonstrate a higher tendency to stop consumption (as compared to the affluent class who consume these products on a daily basis) when the increase in prices exceeds their threshold.

Seizing the future for the entry-level product segment

Balyozyan was very positive about the outlook of the entry-level product segment, stating that luxury brands are trying to widen the consumer base. The luxury brands are not only enlarging their own portfolio of entry- level products, but they are also increasingly opened to collaborating with tech and lifestyle brands. Recently, there has been a very successful collaboration between Swatch and Omega launching the famous MoonSwatch for US$250. This move boosted sales of Swatch and Omega brands, mentioned Balyozyan. Such a move can be considered risky, nevertheless. Strategic pricing particularly in this segment of goods is greatly important. While high prices can cultivate desire, too high prices can diminish brand awareness that the entry-level luxury goods are to cultivate. Voyer further explained that people buy into this category because they want others to notice that they have these items. If the consumer is priced out, the risk is that the brand loses the consumer that will buy in because the audience that will admire will diminish. Apple's iPhone is a great example of driving price increase together with the brand recognition and desire, added Balyozyan.

Luxury goods companies are nowadays refraining from creating the junior lines where they decrease the price and the quality to make their brand accessible to a wider population. The trend today is to manage the portfolio of products in a more unified way under one brand.

Concluding thoughts



Companies that manufacture luxury goods are typically thought of as inflation-proof. This solid position, however, may be questioned in the long run.

Findings on the consumer behavior dynamics towards price increases discussed in this report suggest that the impact of price inflation should not be generalized. For various luxury goods consumer segments, price plays a different role. Furthermore, it's important to avoid assuming that luxury goods consumers will continue to behave in a certain way. While wealthy and ultra-wealthy consumers are not generally concerned about inflation, they aren't oblivious to price rises. They seek price justification, which should be translated into exclusivity and superior quality.

Mainstream luxury goods consumers and entry level goods consumers are likely to be affected by the price increase the most and particularly in these segments companies might be cautious and not nudge their consumers away. The Chinese consumer is increasingly purchasing domestically. Also, there has been an evident rise in Chinese luxury brands. This pushes traditional global luxury goods companies to adjust their portfolio and pricing strategies. Gen Z is looking for durable values while willing to experiment, making price and portfolio strategies even more crucial for luxury players to be successful in attracting the new generation. As brands are increasingly trying to be relevant for different type of consumers, the brand product portfolio is expanding. Pricing, planning processes, and environmental standards drive the importance of cost of capital management for luxury goods companies.

The price of luxury goods is anticipated to rise in order to retain exclusivity during inflationary periods. To master the pricing in the current market, luxury companies should have a wider understanding of macro- and micro-economic dynamics.

Companies can consider investing in:

01 **Consumer intelligence,** which provides a base for helping to drive brand desire.

02 **Pricing strategies** that balance transparency and exclusivity across channels.

03 **Product portfolio management and planning** to help ensure optimal performance of capital.

04 **Omni-channel solutions** that help make technology part of the value delivered by luxury goods.

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