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Luxury Dynamics

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This chapter presents the luxury sector and how luxury brands can be managed in a modern, critical way. It explains all you need to know to understand what is different about the luxury sector, including key concepts like value and value creation.

Overview of This Unique World

As presented in the previous chapter, the concept of luxury is indeed complex: it is difficult to define because it is difficult to perceive as distinct from other sectors. This multidimensional notion has evolved throughout history, from prehistory to the twenty-first century. Originally, luxury was

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the result of hereditary social stratification; it was a social marker. From the opulence of the pharaohs to the fabulous Italian palaces, luxury was a symbol of ostentation. Over the years, luxury became less aristocratic and more bourgeois; brands appeared and multiplied; then industrialization developed. Gradually the notion of luxury became more complex: a market established itself, and industry awoke.

The first luxury organisations in France and in Italy were "family houses",[1] particularly in the fashion industry. In France, the family-owned business model dominated until the 1950s, when the Comité Colbert (a committee of 75 French luxury houses) was created. It was a symbol of a new age in the luxury industry, with increasing numbers of luxury groups. Indeed, it was the age of industrialization, and companies balanced their uniqueness, their knowhow and their production costs. Finally, in the 1990s, Bernard Arnault began to build a genuine luxury empire through mergers and acquisitions: it was the beginning of conglomerates and new management methods. Now the French model is dominated by this type of organization. This sudden emergence of international, multiproduct firms was the result of the acquisition of a whole series of independent small and medium-sized enterprises (SMEs) selling specialized products under famous brand names (Chatriot 2007). In Italy, the economy has been driven by the family model and entrepreneurship for a long time. In these SMEs companies, management focuses on long-term objectives to preserve their "family identity". The SME organizational model is more integrated; firms control distribution and are close to local industrial production and knowhow (Colli and Merlo 2007).

Beyond this "historic dimension", the luxury market is huge, dynamic and international; it exceeds €850 billion and has an overall growth rate of 7 %. It is also a heterogeneous market composed of nine segments, including personal luxury goods, cars, luxury hospitality, luxury cruises, designer furniture, fine food, fine wines and spirits, yachts and private jets, as explained in the report by Bain & Company.[2] Results vary widely between categories, and require in-depth analysis if conclusions are to

[1] "A business where more than half of the total shares are under control of the members of one family" (Som and Blankaert 2015, p. 158).

[2] Bain & Company, Inc., Luxury goods worldwide market study fall–winter 2014.

be made from them. For example, in 2014[3] when the luxury car market (€351 billion) grew by 10 %, designer furniture (€18 billion) decreased by 1 %. In addition, organizations are also heterogeneous, in terms of business structure. So, what exactly do we mean when we refer to the luxury market? It is important to define boundaries, because business models change. As Kapferer and Bastien (2008) explain, the luxury industry includes four main business models, depending on the proportion of products or services. The first two models, used for products such as fashion, accessories, jewellery, watches and automobiles, concern brands with extremely profitable core products. The third one involves the luxury services industry, such as hotels, and the last concerns high-tech products and services. These business models have management specificities. Some brands need to diversify their product portfolio to survive. For example, haute couture companies have to balance their core products and business with cheaper products. For heavy industry fixed costs are very high, and companies usually have to manage prices depending on their activity. This is the case for the hospitality industry, private jets and the cruise business. Companies producing high-tech products must innovate constantly. There is however an additional, all-digital, business model. Gemmyo is an excellent example in the luxury industry. This company, founded in 2011, sells exclusively online and produces to order. The model, related to lean manufacturing in the automotive industry, guarantees low prices—40 % lower than the market. The model also minimizes inventory costs. Gemmyo is an illustration of how the luxury sector evolves in line with transformations in the external environment. Each business model has its own rules in term of structure, organizational processes and management, which strengthens the diversity and complexity of luxury businesses. Each organization chooses a model in line with its objectives and its internal and external context.

Given that the evolution of the luxury sector is related to the evolution of society, it is essential to observe our dynamic environment if we are to understand critical success factors (CSFs) in the luxury world and how to manage luxury brands. More precisely, we have to consider the global environment of the luxury sector: the "luxury ecosystem". Indeed, each

[3] Bain & Company, Inc., Luxury goods worldwide market study fall–winter 2014.

company is a dynamic unit in a global network where "heterogeneous actors with specific competences intervene in the value creation process in different degrees and at different moments" (Depeyre and Seraidarian 2015). In the luxury industry, stakeholder profiles are extremely varied. Some are international suppliers; others are small scale companies or "craftsmen". Since the 1980s and 1990s, the luxury market has experienced one- or two-digit growth, depending on the sector. Globalization and digitization have led to enormous transformations in the industry. The world of luxury has changed; the rules are no longer the same.

Although the luxury market is mature, the number and variety of new luxury goods is increasing, and since the 1980s luxury has become more "democratized" (Silverstein and Fiske 2003). Consumer behaviour has changed, a class of wealthy people has emerged the world over (Som and Blanckeart 2015) and owning branded items has increasingly become part of popular culture. Finally, the inclusion of low labour-cost countries in modular production systems enables low-cost mass production of high quality products (Truong et al. 2008), with the appearance of "premium brands", such as American Calvin Klein and Ralph Lauren (Riot et al. 2013). On the other hand, some mass market or commodity brands, such as H&M or Zara, used "luxury strategies". These market dynamics impacted on luxury organizations and changed value chains. For example, small independent suppliers disappeared and some international companies acquired specialized knowhow by buying out their suppliers, such as Hermès, which purchased its oldest historical leather supplier, "Les tanneries du Puy", in 2015.

More recently, digitalization has given consumers a huge choice of readily available products and brands at affordable prices. The result of these changes is the phenomenon of trading up and trading down[4] (Som and Blanckaert 2015). For this reason, luxury products and services now have to distinguish themselves as commodities and premium products, and show their uniqueness by exploiting exclusive resources and competencies. Luxury brands have to create genuine value for everybody, starting with the client. Therefore, luxury brands are now developing their

[4] For more information see: Silverstein, Michael J., Neil Fiske, and John Butman, *Trading Up: Why Consumers Want New Luxury Goods–and How Companies Create Them*. Penguin, 2008.

own "comeback" strategies: returning to their origins, focusing on the brand's history and becoming more selective.

Hyper-connected, well-informed, consumers are increasingly demanding and are becoming stakeholders in the brand creation and development. They contribute actively to the life of the brand and compel firms to adopt new strategies and organizational transformations (Kotler et al. 2012).

The co-creation process is the main example of this (Hatch and Schultz 2010). All this raises the question: who is the luxury client? Now, luxury clients are not an "elite" but include very different characteristics depending on their cultures or profiles. They can be exclusive, occasional or regular consumers, and with the emergence of new luxury markets, such as China, India and Brazil, they can come from a variety of cultures. Indeed, whilst the American and Japanese markets continue to grow slowly and the European market remains stable, emerging markets consistently support market growth, introducing a new consumption style. New clients such as the Chinese perceive luxury products with different sets of parameters (Okonkwo 2009). The luxury goods industry is also driven by tourist spending,[5] so the challenge for luxury brands is to understand the buyers themselves better, rather than where they buy. In addition, as mentioned above, the rapid growth of digital information and new technology has modified consumer behaviour. Clients now want everything immediately. "New luxury" is defined by a "client-centric approach"; the consumer's viewpoint and experience is central.

In this context, is it possible to speak about luxury as an absolute or as a relative concept? And is this relativity on the level of culture, or of the business model? Or does it mean taking into account the fact that stakeholders in the luxury industry can be very different, with contrasting models and sometimes opposing objectives?

In this complex situation, managers have to find the right strategy to manage their brand, and particularly value, because the main characteristics of the luxury sector relate to value creation. Luxury goods consumption involves buying a brand that represents value both to the individual and to significant others (Wiedmann et al. 2007).

[5] Bain & Company, Inc., Luxury goods worldwide market study fall–winter 2014.

Value and Value Creation: Key Concepts in the Luxury Sector

Interview: Margaret Henriquez—Champagne Krug

What is value in luxury and value creation in the luxury industry, and more precisely in Krug?

Luxury doesn't exist without value creation. The basic rule in luxury is that you always have to go further than what already exists and shed new light on things. This is why you really have to innovate continuously. That is how you create value, by surpassing yourself.

Building value doesn't mean cutting costs to save money. It means adding valuable features that we can use to create added value. That way we can keep investing and keep building value. We create a virtuous circle; that's how you create value.

Krug represents the art of the contrast … [It's full yet fine; it's fresh yet mature; it's magical yet modern]. Krug is a unique type of champagne house. Unique in its refinement … we work on detail, we never compromise. But it's never for perfection, it's for pleasure. We all insist on consistency and continuity while striving for modernity. Everybody in our house knows how they contribute to value creation. It's all in the contrast: demanding in our modernity and in our continuity based in our roots.

This section will explain what value creation means in the luxury sector, and how luxury creates value. Value creation is a central concept in the management and organizational literature, at both micro and macro level. From the strategic or marketing perspective, value creation concerns business owners, stakeholders or consumers; in human resources management or organizational behaviour, it concerns individual employees or employee groups (Lepak et al. 2007). Depending on the theoretical perspective, value creation is defined in different ways. For example, in strategic management Porter (1985) argues that value comes from diverse organizational activities, and represents the price that clients are willing to pay for a product or service. In the resource-based view (RBV), unique, rare, inimitable resources provide competitive advantage (Barney 1991). It is usual to distinguish between two dimensions of value: use value—the consumer's subjective valuation of consumption benefits; and exchange value—the amount the consumer actually pays, representing revenue to a value system (Bowman and Ambrosini 2000).

In luxury, the perception of value is difficult to define. Indeed, luxury has two major value dimensions, because luxury has two value perceptions: personal and non-personal, or luxury for oneself and luxury for others (Kapferer and Bastien 2009). So, purchasing a luxury product can be linked to personal motivations, in a hedonic view, or to a desire to "show off" (externalized luxury). For this reason, brands have significant power over purchasing intentions.

> In luxury, if somebody is looking at somebody else and fails to recognize the brand of his watch or to have an idea of (know) the price that goes with it, part of its value is lost. It is essential to spread brand and worth awareness far beyond the target group. This is the only way to build the distinctive facet of the brand (creating desire in the eyes of others). (Kapferer and Bastien 2009. p. 319)

These two facets can co-exist in one consumer and can be different, due to the cultural dimension (Vigneron and Johnson 2004).

Hence, managing value creation is a major challenge in today's luxury industry. In addition, due to environmental changes, luxury firms have to create value continuously. After the move towards popularization, organizations have to regain recognition. This means luxury brands must recreate a specific link with their extremely heterogeneous clients. Through the brand universe, the luxury firm has to reinvent a unique interactive experience for its clients.

Here, we are talking about a specific value creation process: first, on the value chain (Porter 1999), and, second, in brand development.

The supply chain is defined here as a network of firms that contribute both upstream and downstream to the different processes and activities that create value in the form of products and services provided for the end consumer (Christopher 1992; Mentzer et al. 2001).

Value creation comes from the management of each process through the supply chain, and in the complementary and specialized resources that support them. More particularly, in the RBV, dynamic capability view, value creation can originate in complementary, specialized resources and competencies, as well as in the capacity to create unique combinations (Teece et al. 1997; Wernerfelt 1984).

In the luxury industry, expertise and knowhow are essential. Indeed, luxury professions require particular expertise, the unique knowhow of

craftsmen, which must be passed on over time and also evolve in line with transformations in society. It seems therefore essential to identify this key knowhow and maintain it within the value chain.

Second, brand development: a brand enables the organization, or the structure that supports it, to position and differentiate itself. Its increasing role in society gives organizations competitive advantage (Kapferer 2007; Craciun and Barbu 2014). Thus, developing a brand involves creating a series of non-negotiable values that provide it with a unique identity. More particularly in the luxury sector, brands represent the firm, its values and all the underlying perceptions that customers adopt (Bastien and Kapferer 2008; Dereumaux 2007). They provide a symbolic dimension and emotional value. More recently, the gradual digitization of brands is transforming them into a vector for a wide range of exchanges. The name is the consumer's first contact with the brand, and it must operate as the way into a unique universe. Based on this name, the brand creates a specific, one-of-a-kind language to give it meaning. The language must evoke a world that respects the consumer's opinion. Whilst constantly listening to consumers and proposing new offers, the firm that manages the brand must ensure that the consumer does not feel harassed. Now the consumer is a part of the brand and contributes actively to the brand construction. Organizations have to think in a different way. The notion of brand, still considered as identity building, has taken on other dimensions. Some authors speak of a new, more global, more integrated, more cross-functional brand vision. The brand does not exist only for the customer, but is positioned at the heart of the organization and its consumer relations (Michel 2013; Kornberger 2010; Hatch and Schultz 2010). Consequently, brands develop differently; they have to bring together a community of individuals: customers, suppliers, investors and so on, who do not all necessarily have the same objectives with regard to the brand. This necessary balance between the different stakeholders and the brand has given rise to a new model that some call "brand ecosystem" (Lautissier and Angot 2009). The idea of this is to create and maintain durable relations between the brand and its community, which will become as one. The key notion is now experience: the brand gives people a unique experience, which they share with the rest of the community.

Today's luxury firms find themselves in an unstable, constantly mutating environment. Markets are increasingly competitive, with new players, emerging markets, new client profiles and the emergence of the internet,

which has changed consumer–manufacturer relations. So, the challenge is enormous. To create value continuously, luxury organizations have to adopt strong, dynamic strategies to highlight their roots and the values of their brand, and thus maintain their identity and prevent it from losing its strength (Sylverstein and Fiske 2003; Hoffmann and Coste-Manière 2011; Riot et al. 2013). At the same time firms must anticipate market trends. This means that luxury brands have to guarantee a "fixed" identity, the "DNA"[6] of the structure that bears it, giving it a face, a personality and a soul. But the brand must also position the structure within its environment. It guarantees uniqueness and, as such, it has to evolve to enable the organization to retain its competitive advantage. How can this paradox be managed?

It is necessary to understand luxury brand management, how it is supported and which processes it is responsible for. More generally it is necessary to fully understand all the processes—from conception to delivery—of luxury brand management.

A New Vision of the Luxury Brand: Brand as an Output

Brands, the key asset for luxury organizations can be viewed in a specific way. Indeed, to understand fully the processes and competencies supporting the brand and how to manage the paradox, once can consider the luxury brand as an output. Thus, the brand becomes the result of the processes developed and transcribed not only by the firm (Rigaud 2009), but also outside the firm, since the brand can be co-created with customers (Hatch and Schultz 2010) and other stakeholders (Michel 2013).

The brand is thus: a corporate activity, which initially creates products and value using the organization's internal resources, but then using external resources, which take an active role in the brand's development and renewal. The brand can be considered as an identifiable result, modelled and remodelled by different internal and external actors over time.

More precisely, the brand is the result of the actions of various departments within the organization: principal and support activities (following Porter 1999). It is also the result of processes outside the organization, such as innovative processes implemented by suppliers (Michel 2013), distribution processes and, of course, co-creation processes with customers (Kotler et al. 2012), and sometimes with other stakeholders.

So, the brand can be viewed as the result of interactions in different value chains: the upstream supply chain, the support organization, and the distributors and customers downstream. Therefore, it is important to understand value chain dynamics and how they can create value.

[6] DNA: deoxyribonucleic acid: it means the core value—the identity.

Understanding Dynamic Processes in Luxury in Order to Manage Opportunities

As mentioned in the first two sections, in the increasingly demanding luxury environment, the structure of luxury sector has changed fundamentally. Indeed, with industrialization, the creation of multi-brand groups (in international corporations), emerging markets and relocation, the rules have changed. Value chains have been modified, with vertical and/or horizontal integration. In this fuzzy world, luxury companies aim to retain key resources and create value continuously. This value comes from specific resources and competencies in the luxury sector and also comes from all processes along supply chains and within companies. Value results from the interaction between the brand and stakeholders, and in particular, clients. With this bottom-up strategy, consumer behaviours and new technology have created a genuinely innovative dynamic in the luxury sector.

More particularly, when considering brands as a specific asset, bearing marketing rules in mind is crucial to luxury management. Indeed, these rules often provide valuable guidelines for strategy orientation. Luxury products and services are unique; they have a unique history and heritage; so positioning is not an issue. Luxury must appear inaccessible (rare and expensive), and at the same time must enable a large number of consumers to dream. As such, it must be everywhere internationally, but must not be easy to purchase. Thus, luxury must remain at a distance from consumers, and at the same time must let them be part of its universe, by providing them with a unique experience and interacting with them.

Managing a luxury brand includes guaranteeing extremely high product quality and services using a structured, reliable production system and controlling the supply chain; creating a tangible and intangible universe to tell a unique story, relying on creativity and innovation to remain unique; controlling image, distribution and brand architecture (portfolio development); and, finally, protecting the brand's territory to retain its uniqueness and distinctiveness (Keller 2008).

These different elements highlight the fact that luxury management today is an extremely contradictory activity, together with the importance of understanding and controlling the different processes and interactions involved between the design of a product or service and its delivery to the consumer.

For this reason, a cross-functional view is necessary, including finance, strategy, marketing, economics and law, to understand fully each process together with how it relates to value creation and management.

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