

Analysis of the Impact of the Epidemic on the Luxury Goods Industry and Countermeasures

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ABSTRACT

Covid-19 has had a profound impact on various industries. This article analyzes the impact of Covid-19 on the luxury industry and presents possible solutions to mitigate the current industry downturn. The following conclusions can be drawn that the sudden shock of the pandemic causes slower economic growth, lower employment, and negative public expectations. All these factors lead to the negative trend of economic development in the luxury industry. At the same time, some solutions are given. Luxury firms can give up traditional handmade mode and turn to the modern machinery production to increase efficiency and decrease costs. The method that expands the brand image to the light luxury concept and launches cross brand products can help the firm to enlarge its customer groups and attract more demands.

Keywords: *Pandemic, Luxury goods, strategy*

1. INTRODUCTION

With the high development of economics in current years, the average income in the most countries have been growing and people's living standards has improved. The global sale of luxury goods has increased by 10% to 191 billion dollars from 2010 to 2011 in terms of the state from one of the most famous consulting company, Bain & Company. With the incentive of emerging markets, the increase of wealthy in individuals all over the world, and growing demand among middle market consumers, the luxury goods industry is expected to be growing continuously.[1] Under this circumstance, the demand for luxury goods increases constantly. The sudden crush of the covid-19 hit the world. The infectious disease spreads its harm not only to human's health but also to the market. In this paper, the impacts that the pandemic brings to the luxury industry will be pointed out and be analyzed from a basic economic theoretic perspective and from a perspective of the chain reaction with support from the multisource supply network model. Besides, this paper will point out some realistic solutions will be pointed out. This study can help the luxury goods firms to find out the factors that incentive the negative growth rate of the economic growth in this field and provide recommended solutions to help them recover in the recession.

2. ANALYSIS OF THE IMPACT OF THE EPIDEMIC ON THE LUXURY GOODS INDUSTRY.

Before the pandemic, with the rapid development of technology and the transportation, both domestic and international market for majority of nations have seen an obvious growth. Once income increases, the demand for inferior goods will decrease and consumers will turn to better alternatives. The positive trend of the economic development brings people better expectation and would like to consume more to improve living standard. Driven by this type of thought, more disposable income is spent, and higher purchasing power is shaped. Eventually, the desire for luxury goods will be strengthened and the demand for luxury goods will be increased.

But the sudden crush of the covid-19 will force the nation to halt of its operation of the whole nation, even its trade. Taking an example of Iran, The rapid rise in infections there is likely to disrupt the country's production and trade. As the virus spread in Iran, authorities closed schools and cancelled art and film events, and neighbouring countries closed their land borders with Iran.

It was said by Galloni that although events in the economic, social, and political environments (e.g., economic downturns, terrorism, and natural disasters) have impacted growth in the industry, in certain sectors

(i.e., watches and jewelry, champagne and spirits, perfume, and cosmetics), overall, the luxury industry is proving to be less cyclical than analysts originally predicted. This factor may be attributable to star brands (e.g., Louis Vuitton, Parfums Christian Dior) with demonstrated resiliency and leadership in the recovery from the most recent global economic recessions. Furthermore, it is normally recognized that luxury goods are commonly inelastic in the market.[2]

However, when it comes to the situation in 2020, he was totally wrong. In fact, the stable development of the industry was paused from 2020. The sudden exposition of the Covid-19 hit the various of industries around the world and so did the luxury goods industry. Table 1 is the income statement of LVMH, the largest comprehensive luxury company in the world, we can find that the firm’s revenue is lower than in 2019 and 2021. During the year of 2020, the time when a pandemic is spreading severely all over the world, we can find that the number of the firm’s revenue is lower than the revenue in 2019 and 2021. When it comes to the net profit, the condition is even worse. The net profit in 2020 is nearly half of the net profit in 2019 and one-third of the net profit in 2021.

Table 1 Annual income statement of LVMH

	2019	2020	2021
Revenue	53,670	44,651	64,215
Gross margin	35,547	28,780	43,860
<i>In % of revenue</i>	<i>66%</i>	<i>65%</i>	<i>68%</i>
Profit from recurring operations	11,504	8,305	17,151
<i>In % of revenue</i>	<i>21.4%</i>	<i>18.6%</i>	<i>26.7%</i>
Net profit	7,782	4,955	12,698
Group share of net profit	7,171	4,702	12,036

The above is an overview of the impact of the epidemic of the luxury goods industry. Next, this study will take LVMH as an example to analyze the impact of Covid-19 on the luxury goods industry from the perspective of economic principles.

Basically, the first thing that this infectious disease will influence is the labor force. Instability and financial insecurity immediately follow as a major concern, many people have lost their jobs, and the future of the economy is unknown. [3] As more and more people get sick from this disease that has the characteristics of high spread and infection rate. More and more workers are not able to work and even worse, in the beginning of the pandemic, without effective treatments and a prepared immune system, the death rate of the illness is high and causes a direct decrease in the labor force. A recent article estimates that the total value of losses incurred by a

severe global influenza pandemic (such as the 1918 pandemic) could reach about US\$500 billion per year, i.e. about 0.6 % of global income. [4] And according to a survey conducted by McKinsey & Company on the Brazilian consumer in the Covid-19 crisis, 80% of respondents feel pessimistic, 40% are afraid of losing their jobs, 50% have had their income reduced and 70% is cutting back spending. [5] Take an example in Italy, the place where many luxury brands gathering around. The pandemic booms in the end of the March in 2020. Meanwhile, based on the data from Trading Economics (Figure 1), we can observe that the employment rate in 2020 suffered a sudden fall since

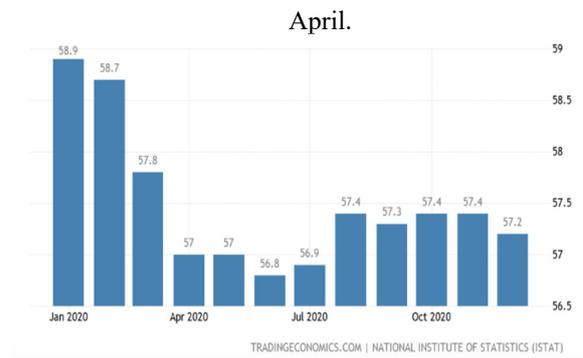


Figure 1 Employment rate of Italy in 2020

With a low level of employment rate, people’s disposable income will be reduced. Purchasing power is weakening and consumption will drop. With the intervention of scarce economic factors and resources, people will take time to resume consuming in a “normal” way, so consumers will value the immaterial aspects over the material aspects of the products. [6] As one of the involved elements when calculating the total output of the nation, the GDP of the nation will be influenced negatively, we can find this phenomenon on the basis of the data from Table 2. This trend will reflect the information that the nation’s economy is undertaking a negative-growth process. People’s expectations of the nation’s economy will be lower, and the market will lose the investment as people are not willing to invest anymore. According to Bell (2020), in a research report for WGSN, fear seems to spread even more rapidly in the digital age in which we live, there is an emotional contagion where people imitate the feelings of others on a global scale. News of high rates of unemployment, deaths, financial crisis are delivered through television, newspapers, social media, messages over the phone, increasing the psychological weight of events announced 24 hours a day.[7] If the government wants to use some monetary policy to treat the condition, it can even make it worse. In order to stimulate people to invest and consume rather than save money, the interest rate should be set at a lower level. But under these circumstances, the hot money will inject into the money so rapidly that the result of inflation will be easily to be formed. Luxury goods are inelastic to the price change in the market, but

if they meet the situation where people’s expectation, people’s demand and inflation happen at the same time, it will definitely become an elastic product.

Table 2 Annual GDP in Italy from 2019 to 2021

Evolution: Annual GDP Italy		
Date	Annual GDP	GDP Growth (%)
2021		6.6%
2020	\$1,884,940M	-9.0%
2019	\$2,005,140M	0.5%

Meanwhile, modern manufacture prefers to operate the process of producing under the system of the division of labor as using this system can reduce cost and improve efficiency. For instance, the famous vehicle manufacturer Ford was once faced with a challenge that the demand for their new series of cars, The Model T, increased too fast to balance the amount that the firm was able to supply at its maximum productivity under its original production method. Later, the firm decided to break assemble of Model T into smaller tasks, and each worker was trained to handle only a few steps of assembly. Ford finally caught up with the great demands in the market and save huge amounts of production costs. [8] However, with this type of system, there exist one problem. In the whole assembly line, if one section is not able to work, the whole producing process will be halted. It is commonly known that, most high level luxury goods are hand-made crafts. Taking the example of Hermes, the delicate brand insists on the concept that every handbag should be made by hand but not by machine and the composition of its product is divided into several parts and for each part there will be workers who take charge of. If one of the workers in the section which has a duty of designing the zip of the bag is infected, the whole section has to stop working to ensure the infection will not be enlarged. At the same time, the whole producing process will be stopped. Eventually, the supply of luxury goods is also negatively influenced. Both supply and demand will influence the price. If the demand surpasses the supply, a shortage of products will occur and the price of the luxury goods will be increased.

Similar to the concept of the division of labor, when we turn to the whole supply network, we will also find the chain reaction on the basis of the high reliability among the different parts in the whole supply network. In fact, there are several models that can help us to understand the relative precise dependence of different parts to each other in the whole supply network. This part of explanation will introduce one type of supply network model, which is the multisource model.

In the beginning, the definition of the multisource model is what I would like to talk about. A supply network is a cluster of suppliers that assist a business in adding value for customers by manufacturing and delivering products. Taking an example of the vehicle

industry, before a customer gets the car he wants, the car manufacturer should find the other suppliers who can provide them with parts of the car like the engine, wheels and so on. If anything, accidentally happen to one of those suppliers, the process of manufacturing the car will be influenced. However, the potential risk of the sudden shock, like the exposition of Covid-19, that might attack any part of the whole system is hard to estimate and avoid. Once any of the system has suffered from the shock, the others will also be influenced. What we would like to know is the reliability and the possibility of suffering risks of the firm. Among all models in the supply network, the multisource model is the one that I think can be the most suitable one to put a numerical level to measure to what extent the pandemic affects the luxury goods industry.

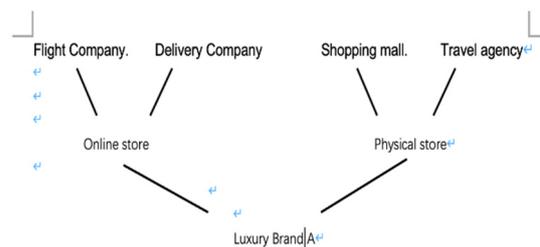


Figure 2 The multisource model of luxury brand A

On the basis of the supply network in Figure 2, assume now we have a luxury brand A. In order to increase the attraction to customers, the brand set up both online store and physical stores. For an online store, the flight company is responsible for the delivery to the customers in a remote place and the delivery company takes charge of the regional delivery of the product. The store’s sales and brand images depend on both firms. On the other side, the physical store will be influenced by the shopping mall as well as by the travel agency. Customers are mainly coming from two parts. One is local people who would like to go shopping in huge departments regularly. The other one is traveler who is attracted by the discounts or the relatively low price in the place. So anything happen to the shopping malls or the travel agency can lead to direct changes to the physical store. Both online store and physical store’s sales, quality and extent of attraction bring about the direct influence on the fame and the brand position of A in the whole luxury goods industry.

Suppose that we would like to find the reliability of A when the pandemic hit each individual part with the probability of 50%.

The probability of normal operation of an airline or express company is: $(1-0.5)^2=0.25$. The probability of either the flight company or the delivery company is functional will be: $1-(1-0.5)^2=0.75$. Then the probability that the Online store is functional will be: $0.5*(1-(1-0.5)^2)=0.375$. The probability of neither online store nor physical store is functional will be $(1-0.375)^2=0.390625$.

The probability of either online store or physical shop is functional will be: $1-(1-0.375)^2=0.609375$. Finally, we can find the probability that A is functional will be: $0.5*(1-(1-0.375)^2)=0.3046875$.

From the calculation above, we can find that even any one part of the whole supply network is hit under the possibility of 50%, the pandemic's crush on Brand A will still occupy a probability of nearly 30.46%. It reflects that there exists high interdependence among the supply network and the potential problem will lead to a risky situation for the luxury brand at the end as the possibility that A can resist the impact of the pandemic is only 30.46%, far below 50%.

To deal with the concern, there exists one method. That is the luxury company can choose to observe more alternative choices in the upper level of the supply network. Multisource supply network is the upgraded one of the single model. A model may lead to the probability of $0.5^3=12.5\%$. We can find directly that the ability to resisting the shock is lower than the situation in the multisource model. So if there are more alternatives in the upper level of the whole supply network, the resistance ability of the firm can be increased.

To help luxury company to face the recession caused by pandemic, there also other methods can be considered.

This paper argues that the transition to meet the concept of light luxury is one feasible way. The mainstream of light luxury is popular these days, and it's the concept that the brand can maintain its image of luxury but to design some style that is close to the fashion style in normal life with a relatively lower price, compared with the price when they set about their style occurring in the fashion show or to the haute couture. The most common way to operate this transition is to issue some cross brand products. For instance, like the series of Louis Vuitton and Supreme in fall winter 2017 to 2018 collection, the whole series 'average market price is about 230 US dollars, which is far below the market price of Gucci 's own products. And the result of these two brand's combinations is worthy. The success of this partnership is highlighted by some indicators. For example, after the collection was released, the prices of the products underwent a significant increase on virtual marketplaces such as eBay or Grailed, specifically they were resold with a markup of around 600%. [7] A relatively low produce can attract customers to buy and the corporation with some bridge brands like the North Face, Supreme etc. the brands which are popular among the younger generation can help luxury expand their consumer group at the same time. Later Louis Vuitton began to collaborate with several brands, very different from each other, because he noticed the enormous success obtained by coming out of the haute couture schemes and connecting to other areas, contaminating sport and casual style with elegance and elegance. exclusivity. The goal of the strategy was to bring young

people closer and make them come into contact with unique experiences that can be lived, or dreamed of, in contact with a luxury brand. [9]

Also, if the luxury brand can give up the traditional hand-made mode in manufacturing and turn to the production based on high-mechanical one can also help the firm to deal with the terrible situation. The high demand of the skill for labor and the low efficiency occupy one part of the high cost of production. If the cost of production can be controlled at a relatively low level, the brand can move its original price level to a lower place, and this will not cause huge losses. At this time, the trouble caused by the division of labor will be solved too. As the most part of the sub-work of the whole product is afforded by different machines but not people and the virus cannot infect the metal labor force and cause any obstacles to the production process.

3. CONCLUSION

In brief, the sudden shock of the pandemic leads to a slow economic development towards luxury goods. The incentives behind the situation can be varied, such as the decreasing labor force, the negative trend in personal disposable income and people's low expectations can cause a decrease in both supply and demand for luxury goods. What's more, the reaction chain system in modern manufacture is also one of the factors accelerating the serious condition. After analyzing the problem in detail, this paper presents some strategies and illustrates sthe basic operation of those solutions. This paper only talks about the problem and the strategy under economic principles and excludes the professional study in social behavior like the customer's behavior. This field of study is what can be further explored in the future.

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