What Path Do Luxury Brands Follow on the Eve of the Economic Crisis?

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Abstract. The detrimental effects of anti-epidemic tactics have persisted since the COVID-19 epidemic began in 2019. Furthermore, the present financial climate has been exacerbated by the energy crisis and the ongoing conflict between Russia and Ukraine. The current challenges encompass limitations on corporate operations, obstacles to rejuvenating the consumer market, sluggish economic growth, stalling in the enhancement of the consumption framework, and a lessening of the impact of consumption on the economy [1]. The fashion industrial chain has also taken a hit. In the aftermath of the conclusion of the arduous anti-epidemic efforts implemented over a span of two years, the prevailing political and social climate has reintroduced a sense of uncertainty and complexity to the situation. The current year has witnessed an unprecedented level of tension, posing a significant challenge for the fashion sector.

Therefore, this study focuses on how luxury brands should adapt strategically in a volatile market characterized by uncertainty. Based on the data analysis and literature survey, this paper find the global macroeconomics situation is influenced by the inflation and stagflation, the Covid-19 Pandemic and geopolitical instability. These three factors contribute to some new changes in the luxury business, such as the change of consumer attitude and the change of consumer group and the change of price. Then this paper will undertake an analysis of the development of the luxury business under the uncertain economic condition to form more targeted and valuable insight in formulating future strategies for luxury business.

Keywords: Epidemic Economy, Luxury Business, Global Inflation.

1 Introduction

Luxury goods, also called superior goods, are products with a demand that is directly related to consumer income exponentially. In other words, when consumer income increases, they purchase more of these goods and vice versa [2]. Although luxury goods are not daily necessities, which means not everyone has a demand to purchase such commodity, they still play a very important role in the global economy development. According to the statistics of *the Investment Forecast Analysis Report*, the global luxury market sales (including luxury goods and luxury experiences) grew by 5% at constant

E. Marino et al. (eds.), *Proceedings of the 2023 5th International Conference on Literature, Art and Human Development (ICLAHD 2023)*, Advances in Social Science, Education and Humanities Research 806,
https://doi.org/10.2991/978-2-38476-170-8_60

exchange rates to reach 1.2 trillion euros. Such growth was positive across all segments, with the personal luxury market performing particularly well, with sales up 6 per cent to €260 billion. However, luxury goods are very sensitive to the fluctuation of the market environment and the changes in the consumer income [3]. The most recent publication of *the Global Economic Prospects* by the World Bank has shown a downward revision in worldwide growth projections for the year 2023. The revised forecast now stands at 1.7 percent, indicating a decline of 1.3 percentage points from the previous estimate made in June 2022. This figure is the third lowest level of global growth in nearly three decades. As to the research, there is a significant deceleration in global economic development, reaching a critical threshold that poses a substantial risk of recession. This deceleration can be attributed to various factors, including elevated inflation, escalating interest rates, diminished investment, and the ongoing situation in Ukraine. According to Malpass, the President of the World Bank, the global economy is "facing an intensifying crisis of development" and obstacles to global prosperity will persist in the foreseeable future [4]. Such intensive crisis will pose severe challenges to the development of the luxury business. More than half of top executives in the fashion business have conveyed that the expansion of the global fashion industry is expected to slow down due to the ongoing conflict in Ukraine, elevated inflation rates, and the challenges faced by supply chains. It is predictable that the situation will deteriorate in the year 2023. Besides, on the day of May 23rd, 2023, a significant disruption occurred within the global luxury goods stock market. The Luxe.co Luxury Sector Equity Index observed a decline in the value of all 26 stocks it encompasses. Within the realm of the European luxury market, the stocks of prominent entities such as the French luxury powerhouse Hermes, the Italian luxury behemoth Moncler, and the globally renowned luxury group LVMH experienced a fall above 5 percent within a singular day [4]. All of these phenomena can be viewed as signals to inspire the luxury business to adjust its development path on the eve of the economic crisis Thus, the primary objective of this paper is to examine how the luxury goods business will formulate strategies in the future, given the challenging economic conditions. It aims to conduct a comparative analysis of the macroeconomic conditions across several global locations. Additionally, it will analyse the impact of the macroeconomic conditions on the development of the luxury business. Then it will attempt to propose prospective development plans for fashion brands based on the aforementioned findings.

2 Analysis of Global Macroeconomic Situation

Inflation and Stagflation. The latest edition of the *World Economic Outlook* by the International Monetary Fund, released on April 11th, 2023, indicates that the global economic forecast remains uncertain due to different factors such as instability in the financial sector, elevated levels of inflation, the ongoing repercussions of the Russo-Ukrainian War, and the prolonged duration of the COVID-19 pandemic ((shown in Fig. 1)) [5]. In light of the foregoing factors, the anticipated trajectory of global production growth is expected to slow down from an estimated 3.0 percent in 2022 to 1.9 percent in 2023, as indicated by the World Economic Situation and Prospects 2023 report published by the United Nations Department of Economic and Social Affairs (UNDESA) [6]. This number signifies one of the lowest rates of growth observed in recent decades. Upon examining the global economy in a comprehensive manner, it becomes evident that three primary elements will exert an effect on the prospects of the global economy, inflation, and investment markets in the year 2023 and beyond. These factors also exert an influence on the economies of the United States, Europe, and China, which are regions characterized by similar economic conditions. Collectively, they will guide us towards a period featuring diminished economic expansion, elevated short-term inflation accompanied by subdued medium-term inflation, and lackluster performance in financial markets.

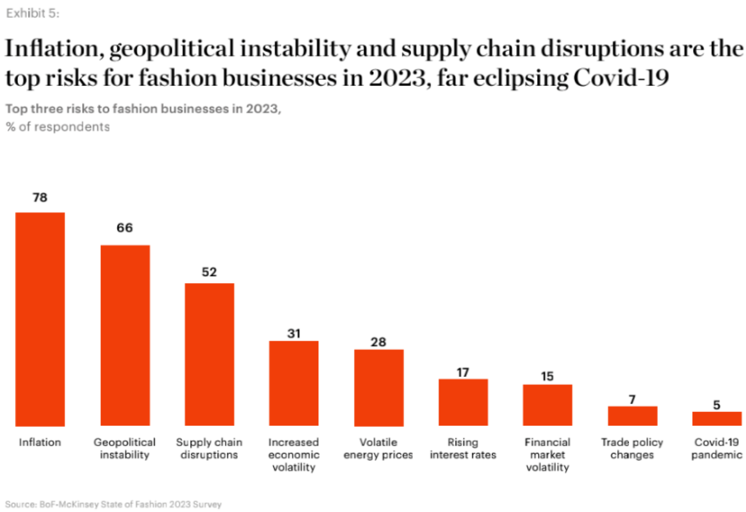

Fig. 1. Top three risks to fashion business

The Influence of the Covid-19 Pandemic. The underlying factor contributing to the inflationary pressures can be attributed to the onset of the COVID-19 pandemic. Consider the economy of the United States, as an illustrative case (see Fig. 2). During the initial months of 2020, the United States experienced a significant downturn in its economy as a consequence of the COVID-19 pandemic, and this downturn was characterized by a substantial increase in the unemployment rate, reaching its highest point at 14.7 percent in May 2020. Before the COVID-19 outbreak, in February 2020, the unemployment rate in the United States was 3.5 per cent, the lowest it had been in the previous nearly four decades. However, after the outbreak led to massive social restrictions, the unemployment rate rose to 4.4 per cent in March. It then rose to 14.7 per cent in April, the highest level since the Second World War.

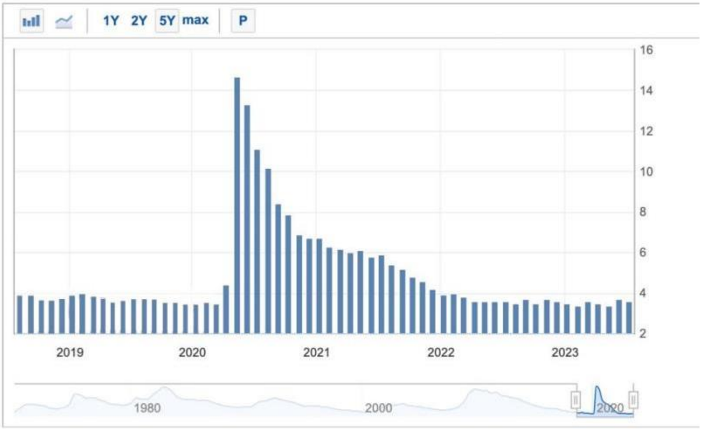

Fig. 2. Bureau of Labor Statistics

Against the background of a recovery in consumption, inflation in the United States (the CPI YoY) continued to rise and peaked in June 2022 at 9.1 per cent. Since then, this index has fallen back. But as of March 2023, it was still as high as 6.0 per cent. In 2022, the CPI in the United States rose by 6.2 per cent year-on-year, a significant increase of 2.6 percentage points from the previous year and a record high in almost four decades. Since 2022, high inflation has become the top economic concern for the Federal Reserve, the Biden administration, and the American public. It also forced the Federal Reserve to raise interest rates sharply and consecutively from March 2022, despite the economic downturn, which triggered the crisis of small and medium-sized banks in the United States in March 2023, represented by the failure of Silicon Valley Bank[7].

Geopolitical Instability. The conflicts between Russia and Ukraine have also received much attention over the past few years. These conflicts are a major blow to the global economy, hurting economic growth and driving up prices [8].

Ukraine is an important grain producer for European countries (See Fig. 3). It is also a major global exporter of food products. As of July 2022, due to the war, Ukraine had about 20 million tonnes of food destined for export trapped in the country. Ukrainian President Zelensky said: “After this year’s grain harvest, the figure could rise to 75 million tonnes.” The war also meant that Ukraine's grain harvest in 2022 would be smaller. Such situation also led to a spike in global wheat prices. Till January 2022, wheat prices increased by about 62 per cent, from USD 6.93 per bushel in 2021 to more than USD 11 per bushel. In early March, the Food and Agriculture Organization of the United Nations released its global food price index for February, in which global food prices rose by 20.7 per cent year-on-year, reaching a record high (See Fig. 4). The United Nations also estimated that the number of people facing food insecurity had reached its highest level in the past 15 years. The outbreak of the Russo-Ukrainian War, disruptions in the wheat supply chain, and rising prices further exacerbated the situation.

Fig. 3. Ukraine's wheat exporting

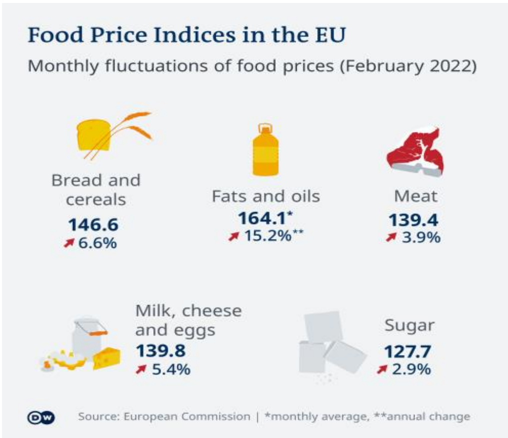

Fig. 4. Food price in the EU

3 Luxury Business under the Volatile Macroeconomic Situation

Generally speaking, the cost of luxury goods is closely related to people's income. If the consumers don't have enough income to afford the luxury goods, they will choose to buy the substitute at the low price. That is to say, the macroeconomic situation has an evident and direct influence to the development of luxury business [9].

The Change of Consumer Attitude. In general, the motivations of luxury consumption mainly include self-affirmation, flaunting wealth, following conformity and seeking uniqueness. Today's luxury consumer goods have become a symbol of value, and also a kind of consumer culture and a sense of personal identification of the same class of people. The social nature of luxury consumption makes it perform much worse than other industries during the economic downturn. During economic recession, people's real income decreases. When some consumers reduce or stop the consumption of luxury goods, the social nature of luxury consumption will lead some consumers reduce to follow the consumption behavior, thus resulting in a sharp decline in the market. This is particularly evident during the COVID-19 pandemic, as the global luxury market shrank by about a quarter in 2020 compared with the same period last year. According to data provided by the company, the S&P 500 luxury goods index (.SPGLGUP) plunged 40.74% from February to March 2020, to 1780.63 points, while the S&P 500 index (.SPX) fell 33.62% during the same period. This indicates that the impact of COVID-19 on the luxury industry is significantly higher than the average for other industries over the same period (See Fig. 5). In 2023, American consumers remain cautious about consumption. Inflation is still a concern for them. While consumers are still spending, they are looking for value. Of the respondents, 80 per cent said they were changing their shopping behavior by buying cheaper goods. In addition, the University of Michigan released its preliminary findings on the U.S. Consumer Confidence Index for May, which stood at 57.7, dropping to a six-month low, a big distance from 63.5 in April [5].

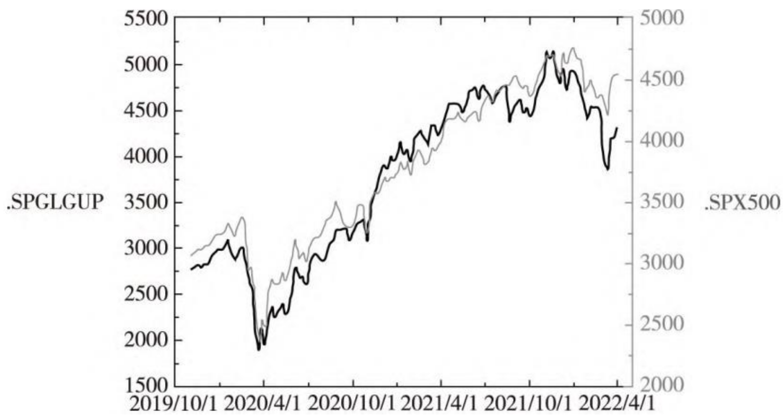

Fig. 5. Comparison of domestic and foreign luxury brands affected by the epidemic

The Change of Consumer Group. Due to the "one child" policy initiated from 1980 to 2015, a large number of "Generation Z" young people grew up in middle-class families, which means that they have more disposable income and do not have the pressure to support their families. Thus, they can have more opportunities and strength to enjoy life than the previous generation. Despite the rise in inflation over the past few years, 40 per cent of consumers still express their eagerness to spend in the coming year. Younger and higher-income consumers, who also are the most optimistic about the economy, are more willing to open their wallets than other age or income groups. While 88 per cent of Gen Z respondents are trading down, 64 per cent are splurging.

Gen Zers and millennials show a particular willingness to splurge on fashion, with 61 per cent of both age groups saying they intend to treat themselves by buying apparel, footwear, and accessories (See Fig 6). Groceries and restaurants are popular splurge categories across all age groups.

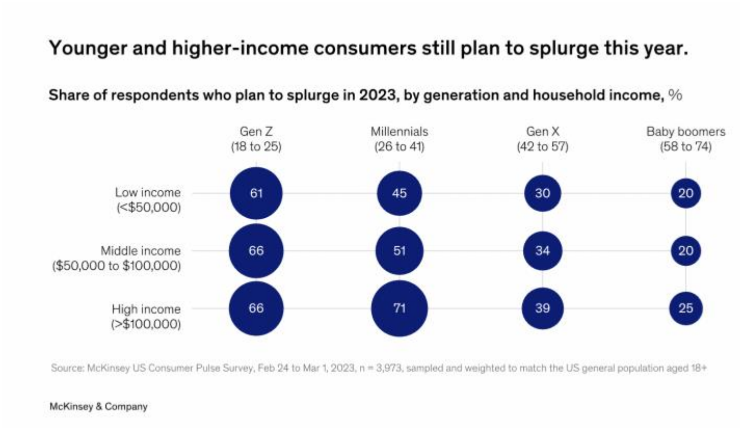

Fig. 6. Younger consumers still plan to splurge this year.

Price Hikes for Luxury Brands are No Longer Sustainable. The turbulent times also bring the possibility of change in the fashion chain. Since the COVID-19 pandemic, luxury brands have used constant price hikes to secure revenue while inspiring consumer buying behavior. Price hikes for luxury brands typically occur about once or twice a year. However, since the beginning of 2020, many luxury brands have increased the frequency of price increases. According to incomplete statistics, since 2020, Chanel has carried out nine price hikes. Louis Vuitton has carried out ten price increases, an average of more than two per year. As for the reasons for the price hike, luxury brands often cite rising costs as the main reason. An LVMH spokesman once said the price hike was due to increased manufacturing and transport costs. Chanel previously announced that the reasons for the brand's increase in the prices of its jewelry and watches were considerations of changes in raw materials and production costs and the constant growth in market demand. However, if looking at the gross margins and cost structures of the luxury groups, we see that luxury goods have higher gross margins and are less affected by rising costs. According to the financial reports, the gross margins of Kering and LVMH were 74.7 per cent and 68 per cent, respectively, in 2022. Obviously, in the age of data transparency, luxury brands are no longer trusted by consumers when justifying price increases by citing "rising costs". Take Chinese consumers, for example. Of consumers surveyed, 54 per cent believe that brands should be responsible for rising costs. In a previous earnings meeting, LVMH Chief Financial Officer Jean-Jacques Guiony said the group would move more cautiously on its pricing strategy this year, focusing on strategic price increases in the face of inflationary pressures. Its brands might not raise prices as sharply and universally around the world as they did last year, sparking widespread concern.

4 Suggestions for the Luxury Business

E-commerce Marketing. Due to the low turnover rate of luxury goods inventory, company has a backlog of products, which can slow down the recovery of funds, thus limiting the company's free cash flow and constraining its growth. Therefore, improving inventory turnover and reducing physical store costs are the tasks that luxury brands should complete. The improvement of online shopping platforms has provided a huge market for luxury goods with greater brand added value. In China, for example, "live streaming e-commerce" has become an increasingly important marketing tool for the luxury goods industry. During the epidemic, offline fashion shows and brand displays in Europe have been suspended, while online promotion has been carried out on Chinese social media, such as Saint Laurent's live show in Tiktok Fashion Week. What's more, brands can also tailor their social media channels to better connect with their target consumers authentically and effectively. At the same time, they can reflect local consumer tastes and trends through localized product development and packaging.

Exploit the Potential Market. While consumer confidence has improved in Europe and the U.S., most remain cautious. However, the good news is that consumers of Generation Z are far more optimistic than those of other age groups. In the future, the luxury market will still be dominated by the Asian market. At the same time, the potential of the Southeast Asian market cannot be ignored. Vietnam has a growing middle class. They are widely spread across the country and are increasingly diverse. In addition to increasing in numbers, Vietnamese consumers are becoming more demanding and selective. It is estimated that by 2035, more than half of Vietnam's population will be part of the world's middle class, generating more disposable income and stimulating consumption. Luxury brands can turn some of their attention to the Southeast Asian markets, especially Thailand and Singapore. The brands can interact with consumers through offline activities to enhance consumers' direct experience of the brand, strengthen the connection between consumers and the brand and increase their brand loyalty. These attempts will help luxury brands to develop in the Southeast Asian market in the long run. At the same time, the consumer power of the Middle East cannot be ignored. According to a new research report released on July 5th by Boston Consulting Group and Altagamma, the Italian trade association for luxury goods manufacturers, the Middle East luxury goods market is expected to reach nearly EUR 15 billion in 2023 and double to EUR 30 to 35 billion by 2030, driven by the United Arab Emirates and Saudi Arabia. [10] The Middle East has unique history and culture and a heritage of ancient craftsmanship. When targeting consumers in this region, luxury brands can pay more attention to their emotional needs. Through events such as branded art exhibitions, brands can connect culturally with Middle Eastern consumers, giving them a sense of identification with the brand. Meanwhile, in addition to apparel and accessories, brands can reach out to consumers by partnering with luxury hotels and developing premium furniture and home furnishings to strengthen the link between consumers and the brand and enhance consumer perceptions of the brand.

Focus on the Consumer Demand of Young People. Western consumers of luxury business are older and have a higher identity. While Eastern consumers of luxury business are younger, with lower social status. The majority consumers of luxury products are college graduates, most of them do not have detailed and careful planning for money, and some even blindly compare with each other in order to pursue trends. Due to the young generation will become the main customers of the luxury business, such products need to be changed. The surveyed college students were further classified into five categories: jewelry luxury goods, luggage luxury goods, watch luxury goods, cosmetics luxury goods and clothing luxury goods. Among them, luxury products in the cosmetics category are the most popular among college students, accounting for 46.67%.(See Fig 7) However, only 10% of college students choose to buy luxury goods such as bags and watches due to their high cost [11].

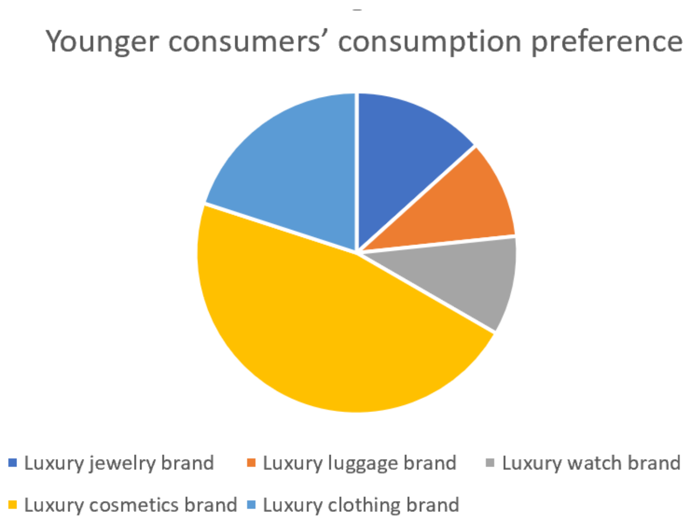

Fig. 7. Younger consumers' consumption preference.

5 Conclusion

Based on this paper, the factors contribute to global economic instability continue to exist. Inflation, geopolitical instability and the influence of Covid-19 remain the three main factors that weakens consumer confidence to spend. In a poll released on July 7th, 2023, McKinsey & Company noted that geopolitical instability and inflation remain the main risks to national and global economic growth [12]. In such an environment, new changes have emerged in the distribution of consumer spending among consumers of luxury products. Consumers have become more rational and look for more cost-effectiveness of products. Thus, the luxury brands should use a variety of channels to stimulate consumer to buy luxury goods and also need to look for more potential markets, such as Middle Eastern consumers. What's more, Z generation become the consumer of luxury products, which means the luxury brands should pay attentions to the demands of young generation and Invest more money and energy into researching products that meet the needs of young people, such as cosmetics and clothes.

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