The Premium of Value: Pricing and Promoting Luxury to the New Consumer

By Tom Jacobson, Ray Florio, and Tiago Salvador
Introduction

While recent news of a global rebound in the luxury market has encouraged retailers, this comeback may be very different from those to which they are accustomed. Rather than finding a mainstay among older, brick-and-mortar shoppers, luxury retailers will encounter younger and savvier shoppers who tend to buy online and at a discount. While ultra-luxury retailers may still be able to play by previously well-established rules—such as avoiding online sales to engender a sense of prestige—mass-market luxury players must adapt to their new customers and the shopping dynamics they bring with them. In particular, luxury retailers will find that a carefully designed online presence, usable insights into competitive pricing, and more sophisticated channel and promotional strategies will be critical to success.
The Changing Luxury Consumer

Few would argue that the luxury market has not changed a great deal in recent years. As growth has slowed in developed nations such as the United States and Japan, luxury-goods companies have intensified the search for competitive advantages in order to capture share from others. The recession created large-scale shifts in consumer buying behaviors, and retailers—even those serving the luxury space—have taken steps to adapt.

To be sure, the luxury market experienced an upturn during the 2010 holiday shopping season. As Swiss private bank Pictet & Cie’s luxury-focused fund manager Caroline Reylnoted, "The luxury sector was the sector to be in [during] 2010." However, one should not assume buyers and retailers are returning to pre-recession behaviors. Consumers, particularly those in the United States, are eager to embrace convenience and value, and are unlikely to revert to their prior mindset, as numerous retail segments have discovered.

Indeed, recent Accenture research shows that luxury shoppers now are younger; that shoppers over age 35 were less likely to purchase a luxury good during the past holiday season, and that those seeking luxury goods cite value and price as key considerations when making a purchase. Moreover, the majority of these shoppers intended to make most of their purchases online. Further, value has become so important that some consumers, particularly in Japan, have begun traveling to less-developed countries to purchase luxury goods at lower prices.

Seeking to capitalize on these trends are the new breed of invitation-only “flash sales” sites dedicated to luxury shoppers, which have grown tremendously in a short period of time. These sites cater to an emerging demographic segment described by Brand Channel’s Barry Silverstein as “luxury newcomers.” In his words, such a consumer is “a web-savvy, discerning fashionista who knows her way around sites such as Gilt.com and relishes a good discount and interactive shopping experience.”

According to Brand Channel, this new segment comprises 61 percent of luxury consumers and 36 percent of luxury spending, an amount equal to traditional luxury consumers prior to the recession.

Feeling the pressure to respond to these changes, many retailers had begun the shift from mid-range luxury goods to less expensive and more accessible luxury goods prior to the recession, with Deutsche Bank noting that the traditional pyramid of luxury levels bore a greater resemblance to a pear. Smart mass-luxury retailers are learning from the past two years, leveraging different channels and seasonal shopping behaviors to tailor their offerings and promotional strategies to distinct customer segments and preferences. The transparency and wealth of information available to consumers via the Internet can help—rather than hurt—those companies that embrace a more sophisticated go-to-market strategy.

However, luxury retailers still face many potential pitfalls in their pursuit of growth. While promotions and discounting can boost their financial performance, especially in the short term, there are dangers in using these tools haphazardly. Loss of margin and prestige among more traditional luxury shoppers, for instance, are a real concern. “The losers in this recession will be the ones who destroyed their brand through the discount model,” Janet Hoffman, global managing director of Accenture’s retail practice, told BusinessWeek. “We won’t see the damage from that necessarily today, but we’ll come back in a year and be able to notice.”

Furthermore, despite the positive effect of discounts on segments of the luxury market, overall spending intentions are not increasing, and upselling customers to a more prestigious product is unlikely if the discounted price is still significantly beyond their budget. Therefore, unless a promotion is targeted to the correct segment, it will only erode brand image and margins. While this is challenging for all retailers, it is particularly difficult for luxury brands, which tend to have less discounting experience. Because of this, such brands likely will struggle to balance long-term image management, short-term financial gain, margin protection, and fulfilling the preferences of traditional and new shopper segments.
Five Key Success Factors for the New Luxury Market

How can luxury providers overcome these hurdles and capitalize on the new reality of retail?

In Accenture’s view, there are five key areas luxury retailers must manage in concert to derive maximum value from today’s transformed luxury marketplace:

1. Embrace the online channel
2. Gain deeper insights into competitive pricing
3. Develop enhanced and coordinated channel strategies
4. Understand price sensitivity for each product in each channel
5. Launch highly targeted, carefully measured pricing and promotion strategies.

Retailers that neglect these areas may witness the erosion of a brand image they have spent decades cultivating.

Online presence

In the recent past, luxury retailers commonly presumed that the Internet was a channel for discounted, damaged, and counterfeit items, and believed that online sales risked overexposing brands built on exclusivity. Some also thought that the channel was not equal to the task of marketing the sensory aspects of luxury goods, such as smell, touch, and feel. As a result, many luxury goods companies have been slow to create their own online channels, ceding control over the online segment to other players such as online-only retailers. In fact, as reported by The Economist, just one-third of the luxury retailers surveyed by Forrester Research in 2008 sold their products online. And while that figure has since risen, as of 2010 half of luxury firms still did not have an online presence.9

To be sure, brick-and-mortar channels will remain important, as they appeal to more traditional, brand-loyal, prestige-hunting luxury consumers. However, given the shifts in luxury buyer behavior discussed earlier, and the fact that new, younger, and discount-hunting luxury shoppers prefer to shop online, establishing a powerful online presence is the first key step for luxury goods manufacturers and retailers.

Online sales are expected to continue growing rapidly: In fact, even through the depths of the current downturn, luxury pure-play online retailers experienced 87 percent year-over-year growth.10 Thus, overlooking the channel will only become more costly. Losses are especially likely among shoppers who research product features and advantages online prior to making in-store purchases. In such cases, luxury providers that do not have an online presence are allowing another party to control the message this segment receives. For brands that tie much of their value to a carefully crafted image, this could prove disastrous.

The experience of well-known designer Oscar de la Renta illustrates the power the online channel has to drive sales of luxury goods. The company has had an online store for several years, which Oscar de la Renta anticipated would primarily serve customers shopping for smaller items. However, bucking expectations, the online store recently has hosted transactions for much larger-ticket items such as fur coats and high-end cocktail dresses.11 Had these items not been available from the brand’s own site, customers likely would have purchased them from competitors or from channels that allowed the retailer less control over its image, and eroded its profits. Having established its own online presence, Oscar de la Renta has minimized any loss of prestige and cachet.

Competitive price intelligence

Understanding the complete pricing landscape in which their product portfolio plays is now more critical than ever for luxury brands. While luxury retailers and brands have highly sophisticated capabilities and means to control their image, many have not exhibited the level of concern with competitive pricing that other retail segments have. With the rising popularity of alternative online shopping methods, from online auctions to flash sales sites to price comparison engines, the need to avoid undercutting
by competitors is high. Indeed, being perceived as overpriced is a clear threat, and is a particular concern for manufacturers with their own retail stores, whose customers likely will react negatively upon seeing significantly lower prices in other outlets.

To be sure, while luxury retailers that have built brands on image and lifestyle can withstand greater competitive pricing differences than discount retailers that have built their brand on price, there are still limits. It is not feasible for a company such as Fendi to match the price of every seller on eBay, but it should understand the range of prices in the market, especially among core competitive channels. A trend of consistently lower prices available elsewhere erodes the impression of value that potential customers cite as so critical to their purchase decision.

For example, recently a high-end fashion house conducted a global pricing study of its top competitors in key countries. It collected pricing data on comparable products across brands and statistically modeled profitability and growth for each. Based upon these results and the company’s desired brand positioning, it set target price ranges for all of its major products. Pricing within those ranges significantly improved customer price satisfaction, thus increasing volume, revenue, and profits, while enabling the company to establish a consistent brand image that was positively differentiated from its competitors.

Enhanced channel strategies

The disparities between online, outlet, department store, and boutique shoppers in the luxury space is just as striking as it is in other retail segments. Not only is price sensitivity different, but access to information and shopping seasonality display wide variation as well. For instance, online shoppers obviously can compare prices across multiple competitors more easily than those shopping in a brick-and-mortar location. But even that is changing, as mobile phone apps such as The Find enable shoppers in physical stores to scan a product on the shelf and instantly know the price for that same item at nearby brick-and-mortar outlets as well as online merchants.

One way luxury retailers can tailor promotions to such divergent customer needs is by emphasizing temporary, special discounts available through the online storefront (which also are available to brick-and-mortar customers who leverage online information), while stressing other features for the brick-and-mortar channel. Furthermore, retailers can meet customer needs without cannibalizing sales or eroding brand image for valuable boutique shoppers by tailoring assortments across each channel. For retailers that still are concerned with eroding their brand image or limiting future flexibility, increasingly popular flash sales sites provide a way to test promotional strategies through a seemingly unrelated venue. These sites not only have a degree of separation from the brand, but also tend to emphasize the scarcity and limited duration of their discounts. As long as this channel is not overused, it allows luxury providers to avoid incorporating these lower prices into its brand image.

Several high-end retailers are responding to the pressures of increased competition and price-conscious shoppers by aggressively investing in the expansion of outlets, similar to the strategy taken by some manufacturers. Indeed, high-end manufacturers such as Coach and Polo Ralph Lauren have a legacy of using outlets to liquidate excess goods without diluting brands. These manufacturers also have extended this strategy to outlet-specific products and promotions, and to online promotions. Neiman Marcus, Bloomingdale’s, Saks, and Nordstrom are following this example, each ramping up their expansion of outlet stores. By adopting this strategy, retailers can maintain a high degree of control while reaching a wider base of customers and shifting discounting away from their regular stores. Neiman Marcus, in particular, began testing a store concept in April 2011 called Last Call Studio that sells outlet-only merchandise. This new breed of outlet stores targets a growing group of deal-conscious customers while minimizing margin pressure and brand erosion with distinct made-for-outlet products.

Price sensitivity

In the past, a high price played an important role in the full experience of buying a luxury item, and retailers believed discounting such a product eroded its perceived value. However, that’s not necessarily the case, especially during peak shopping seasons such as the holidays. In fact, in a recent holiday shopping survey, Accenture found that only one percent of respondents said a discount would negatively impact their impression of a luxury brand, while 70 percent said discounts were the biggest influence in their decision to purchase a luxury good.

Yet luxury retailers should not discount across the board. Many retailers in other segments have experienced substantial improvements in both long-term brand image and margin by understanding the price sensitivity of different items. Contrary to their expectations, they have found that cutting price, within reason, only drives sales for a small portion of their product portfolio. For example, Accenture’s work with home improvement retailers found that their customers are most sensitive to pricing on products that serve to start a project, such as faucets or tiles, and pay far less attention to the associated grout, caulk, screws and hand tools. Purveyors of luxury are very likely to see similar results, and thus should focus their promotional efforts on the products that make a difference, rather than taking a broad-stroke strategy that erodes their images and margins.

In recent years, a well-known retailer incorporated such sensitivity metrics into its overall pricing and assortment strategy. The retailer set the most competitive prices for the small number of price-sensitive products
that brought customers into the store, while setting prices for the larger number of less price-sensitive items that would bolster its margins. This strategy has helped boost the company’s profit margins to its highest level, while also convincing customers they had managed to get a good deal.

Luxury retailers also can improve their results by understanding price sensitivity for each product through each channel. With such an understanding, retailers can determine which items to promote in each channel, differentiating promotions based on clear evidence of customer behaviors. By taking such an approach retailers can prevent the higher sensitivities of online customers from muddying in-store behavior, thus more narrowly targeting their efforts for the greatest impact.

Performance Measurement

It is hard to overemphasize the value of actual testing and learning from one’s mistakes. As with measuring price sensitivity, luxury retailers can learn from the success others have had in establishing a price and promotion testing process, and then thoroughly analyzing the results. Quantifying and measuring success is critical for discovering the optimal allocation of limited promotional dollars.

Understanding both the financial and brand effects of an actual promotion or a price change will shape and refine the overarching pricing and promotion strategy in each channel in a continuous cycle, allowing the company to adapt as customer preferences change. This will help retailers avoid outdated promotional strategies that do nothing other than hurt margins without any positive financial impact. Furthermore, just as deep, attention-getting promotions will limit flexibility by setting customer expectations, less impactful, frequently-repeated discounts will do the same, revealing a clear need for retailers to change with the market, as quickly as possible.

A high-end department store demonstrates the value to be derived from promotional metrics. Responding to limited returns from its advertising and promotion activities, the retailer embarked on an effort to improve the marketing decision support data, tools, and frameworks available to its merchants. This allowed merchants to quantify and act on advertising performance based upon the item selected, the discount, the messaging, and several other factors. The result was an almost immediate increase in advertisement effectiveness, driving increased sales and store traffic through smaller markdowns. In essence, the retailer was able to generate the returns it needed through much less risky and less potentially brand-eroding promotions.

Conclusion

Although many luxury retailers stand to benefit from the recent rebound in demand for their goods, they must ensure they are equipped to properly serve a market that is very different—both technologically and demographically—than the one they served prior to the recession. In particular, a greater portion of luxury consumers are younger, shopping online, and seeking value. They have grown up with technology and have learned to leverage it in more sophisticated ways to truly understand the quality and value they receive for each dollar they spend.

The smart luxury retailer will cast off long-standing misconceptions standing in the way of fully leveraging channel and promotion strategies to serve their disparate customer segments. For many, this will mean putting in place carefully designed online capabilities, striving to understand how competitors are pricing and how channel strategies can be optimized, and tapping into the full power of price sensitivity analysis and promotional metrics. Fortunately, the way forward is illuminated by the experiences of other retail segments that have faced similar situations in recent decades. By learning from these segments, luxury retailers can continue to provide their customers with premium value, thereby supporting their pursuit of high performance.
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