When Rodeo Drive, Bond Street, and Madison Avenue Just Are Not Enough: Changes in Luxury Goods Distribution in America

ABSTRACT

The past two decades have witnessed spectacular changes in luxury good consumption in America. Consumers are spending more money, their medium age is falling, and the overall market is performing well. Those exclusive goods once reserved for the upper class are now found in the hands of the middle class consumer. With an increased market for these once highly exclusive items, companies must now modify their distribution medium to increase access to their new consumers. This paper explores use of the Internet as a means of reaching this growing demand, while arguing that it will not diminish brand equity.

NULL HYPOTHESIS: Luxury goods must be distributed in traditional flagship, boutique style stores in order to preserve brand equity.

ALTERNATIVE HYPOTHESIS: More modern forms of distribution are needed to reach the growing purchasers of luxury goods and can do so without eroding brand equity.

DEFINITION OF A LUXURY GOOD

In order to gain and to hold the esteem of men, wealth must be put in evidence, for esteem is awarded only on evidence.

Thorstein Veblen
The success of this study relies on an established and consistent definition of a luxury good. Thus, from this point on, luxury goods will be defined as follows: any established brand sold at a premium price, belonging to one of four categories:

1. Clothing and Accessories
2. Watches and Jewelry
3. Cosmetics, Toiletries, and Perfumes
4. Miscellaneous (gift items such as food, confectionery items, and pens)

Although price is obviously an important factor, it is not the only predictor of a luxury good. Houses or automobiles are expensive, but they may or not be considered luxury. Rather, it is the premium over comparable good coupled with an emotional attachment that determines luxury status.

Purchasers perceive these goods as the best quality. But craftsmanship alone is not enough to dictate such extravagant prices—purchases are motivated not only for utility, but for the message the consumption portrays. In 1899, Thorstein Veblen introduced the concept of conspicuous consumption in *The Theory of the Leisure Class*. Veblen argued that as wealth spreads, consumer behavior is no longer driven by substance nor comfort, but the “attainment of the esteem and envy of fellow men” (Veblen 52). Asserting wealth conveys power and achievement, Veblen disregarded the assumption that man purchases purely for consumption.
Certain brands achieved such recognition that they serve as a vessel to communicate wealth. They have forged a relationship with the consumer, leaving him intoxicated with the glamour of luxury and the allure of envy. Although this study attempts to address the many companies engaging in business within the restricted definition, major labels represent the focus. Exhibit 1 illustrates these firms.

These long standing luxury brands were launched in the nineteenth and early twentieth centuries when a strict social class system defined society. The wealthy usually dressed in one label from head-to-toe and drank and ate only the finest foods. These people comprised the top 2% of the population’s personal wealth, ranging between 35 and 55 years old. At the top end of wealth spectrum, elite, and price insensitive, they chose products with little or no utility over cheaper counterparts—and most of all were willing to pay top dollar. “For these reasons, luxury and prestige brands have for centuries commanded an unwavering and often illogical customer loyalty” (“Redefining”). The extremely wealthy remained the core market for a remarkable amount of time.

**DEMOCRATIZATION OF LUXURY**

_Luxury has been greatly democratized; everyone is a luxury consumer or an aspirational luxury consumer._

_Rick Swanson, Gucci’s Director of Ecommerce_

Beginning in the late twentieth century, a younger and less wealthy market emerged. Despite the age polarities, similar desires create an advantage for firms. For example,
let’s examine a retailer with low price points and assume its core market is price conscious, lower income housewives while its fringe market is more wealthy, middle class working women. If the retailer tries to attract the latter group more through promoting its products as more prestigious, it could alienate its core market that wants a no frills, cheap product. In the luxury market, the fringe consumer, who is the potential for the firm, desires similar benefits as the core consumer. Alignment allows marketers to target their fringe customers without alienating the core, and visa versa.

What does this market change translate into for the luxury sector? 2004 saw explosive growth, immune to uncertainties over high interest rates, the US presidential election, and Iraq war. Most firms remain optimistic for 2005, predicting the US luxury boom will persist.

LVMH had its highest profits ever in 2004 ($1.26 billion) despite a weak dollar. "The year 2004 was an excellent one for the group," CEO Bernard Arnault says. "This was obtained in spite of very unfavorable currency impact." Profits were up 40% from the previous year. PPR’s luxury division profits rose 26% in 2005, accounting for 16% of overall revenues. "It's very clear that there will be more growth in luxury this year," said Francois-Henri Pinault, chairman of PPR. "Luxury is strong in the United States…" (Luxury). Specifically, these sales can be attributed the Gucci Group division, with operating income growing eighty % in 2004. More people than ever before are demanding luxury.

“Our US operation is booming," says Patrick Thomas, co-chief executive of Hermes International, “We think it's due to the general economic environment. We think we have
significant growth potential in the US in the 5 years to come.” (“Luxury”). Experts agree an improving economy and consumer confidence drive growth. Moreover, the overall democratization of luxury stimulates the boost. "It's no longer the provenance of the happy few," said Chanel's Cirkva. "Everyone feels entitled to a little piece of luxury…about 70% of our client base in a 12-month period of time is new” (“Luxury”).

Although speculating a bright future, the weak dollar may constrict growth. Because most luxury companies are European, exchange rates raised prices in the US. However, many firms argue that most luxury consumers are price insensitive, but do acknowledge the translation risk.

**DRIVERS**

A more careful examination of the US will determine what economic and social trends fueling this growth. Increase in money and debt facilitate the purchase. Psychological and lifestyle changes motivate the purchases and the preferred point of sale, respectively. Changes in all three factors lead to changes in the target market’s demographics.

**ECONOMIC TRENDS**

Arguably the most important economic driver of the luxury market is the rise in real household income. Since 1970, income increased over 70% (Exhibit 2). Moreover, the distribution this income is favorable for luxury firms. The 20% (households earning over $82,000) of Americans experienced the highest acceleration—the majority of luxury consumers. Holding over 40% of the nation’s family income, the extremely affluent are richer than ever. Include the next 20%, and 70% of income is represented (Exhibit 3)
In 2000, average US disposable household income was $57,798, rising six 6.5% from 1990 at constant prices. In August 2004, according to the US Bureau of Economic Analysis, real disposable income increased by 3.5% and real consumer spending increased by 2.5% over the previous year (Exhibit 4). In addition, household final consumption expenditure has steadily increased since 1990. This trend to spend more money translates into an increased demand for goods (Exhibit 5).

Major contributors to consumer expenditure are college graduates and those with higher degrees. They have seen the greatest growth in real income. This group is considered more “global” than their older counterparts. They are more likely to have a wide range of experiences, tastes, and desires, reflective of increased globalization. In addition, they give themselves permission to spend more, especially on indulgences.

But these increases in income come with an expense: those in the workforce are often working longer hours than before. Consumers have little time to shop at a leisurely pace, and demand more focused purchasing excursions.

In addition, Americans are more comfortable taking on debt than ever before. Over the past five years, consumer credit rose by 35%. This increase is attributed to consumer confidence, financial liquidity, supply competition, and increased credit availability, despite the relatively high interest rates of 1999 and 2000. In addition, the increasing average debt per household grew by about 8%; the highest level personal debt has ever been for the average American (Exhibit 6).
Credit cards are often used for high-ticket items, as opposed to carrying an excessive amount of cash. If more Americans are multiple credit cards and are quite comfortable with debt, they may be more willing to charge a high ticket luxury item. Credit cards allow the middle class consumer, whose income does not traditionally dictate feasibility to purchase luxury goods, to do so.

**DEMOGRAPHIC, PSYCHOLOGICAL, AND LIFESTYLE CHANGES**

**WOMEN**

Although males do purchase luxury, females dominate consumption. Across a wide scope of indicators, statistics point to a variety of trends among US women. This gender continues to dominate the population, works and earns more money than ever before. By 2010, women are expected to control 60% of wealth in the US.

Women also make up a slightly larger percentage of the population than men. In 2000, 51.1% of Americans were female. Women represent 44% of the total force. In 2003, 68 million out of 155 million women, aged 16 to 64, participate in the work force. 74% work full time, with 20% of women working more than 40 hours or more per week (Women’s Bureau).

Traditionally men earned more money per hour than women. In the 1970s, an over 30% premium characterized the male paycheck. Today, men still enjoy a 28% higher average
income over women. While these figures are not that significant, women’s income has increased 22% since 1970, while men’s only 9%. Not only are women working more, but they are paid more.

**TIME POVERTY**

With more women working and both genders spending more hours than ever at their job, Americans are experiencing increasing time pressures. Shopping for pleasure is less indulged, reflected in retail traffic and sales. The increase in time poverty has been especially high for women. As more females enter the workforce, household and family activities must be done after work hours. This puts a strain on both the man and woman in a dual parent household. To combat, they flock to easier and more convenient methods to make purchases, such as mega stores and the Internet.

**INTERNET**

As of March 2005, an estimated 70% of US adults use the Internet as an information source when shopping for products and services — up from 60% in October 2003. Experts predict that the Internet’s influence will surpass newspapers’ in the near future.

**DEMOGRAPHIC CHANGES**
As the purchasing power of the fringe market increases, companies must devote more attention to this younger market. More important than their purchase potential is that the young represent the future of the firm. As these consumers age and become wealthier, companies hope to create of loyalty, even if not as strong as their older customers demonstrated. The younger market is also more willing to indulge.

Effectively targeting these consumers presents a challenge. Characterized by time poverty and more resistant to traditional marketing methods, the younger consumer requires a much more unique approach. This challenge has tested the creativity and ingénue of luxury companies, as they try to devise a faultless strategy, or risk the loss of this highly profitable segment to competition.

Hispanic consumers are one ethnic group that more fashion houses are beginning to target. Such shoppers spent over $8 billion in 2004 on fashion and luxury items, which represents a disproportionate amount in comparison to their relative income levels.

**IMPLICATIONS**

These trends in consumer lifestyles and the retail environment dictate a change in marketing strategy. Americans have more money and are spending more. The increase in working women and working hours per week put time pressure on the consumer. She needs an easy way to shop, that will not cannibalize too much of her rare free time, but still wants luxury.
Some of these trends are quite strong—others are just beginning. But most importantly, industry experts recognize the dramatic change that is occurring in luxury markets—many even go so far as to call it a phenomenon. When a company faces such drastic changes in its market, marketing strategies usually must be changed to stay competitive, including product, price, promotion, and place. Because the quality must be high, the product should not change much, aside from trends. Within the specified definition, prices are still well above comparable goods, despite the fact that companies are lowering their price points or offering cheaper lines that still bear the brand name. The promotion is not really changing either. Luxury goods generally tend to be placed in print, such as magazines and newspapers, and rarely on television.

Distribution is the final component of a marketing strategy, which directly addresses the key change: how to reach an increased demand for luxury goods from people outside the metropolitan market. The traditional distribution mediums are incompatible to this notion. Having a few flagship stores in major cities fails to reach a majority of the market. If they do not act, luxury companies will find themselves missing a new part of their market, and one that is growing tremendously. But how do companies balance the difficult paradox of maintaining exclusivity, yet reaching the growing market? Is exclusivity as vital today as it was fifty or a hundred years ago? In order to answer this question, an assessment of the current distribution strategy must be analyzed. Next, new forms of outlets must be examined, and the implications associated with the luxury market.
DISTRIBUTION TRENDS AND MEDIUMS

EXCLUSIVITY

It can be said that some of the predominant factors of a ‘luxury’ brand are its very exclusivity, uniqueness, and novelty value...In order to create an image of exclusivity, restrictive distribution is the strategy of limiting the number of retailers of a product. Because consumers can only buy the item in a certain store in a certain city, it engenders a perception of exclusivity due to the very fact that it is not readily available to all consumers. (“Pricing”)

Logically this makes sense—one of the best ways to increase the cachet of a product is to limit its availability. We see this at Christmas time, when a supply shortage for a certain children’s toy creates an exuberant demand for it, despite little desire in November. However, this sort of shortage is short lived—eventually the market evens out and you can find the product at a discount in January.

The luxury market used to operate on a similar principle, except without the market mechanism balancing out prices. A cunning strategy of restrictive distribution limited these goods to the upper class, which could not only afford the good, but were willing to travel to obtain it.

Thus, it used to be, once established, a luxury brand could sell on exclusivity alone. The fact that no one else could afford or access a certain good was reason enough for some to purchase it. Toting around this product allowed the consumer to conspicuously show off
his or her social standing. This worked for such a long time that it is hard to imagine luxury marketers ever wanting to change their strategy. They may fear a ruin of their carefully crafted brand image or an alienation of its core market. Now, with counterfeit goods on the rise, competitors creating cheaper alternatives to target lower markets, and luxury more geographically accessible than ever before, exclusivity is a fading predictor. Most middle class consumers do not mind if those in their social circle have the same brand (Silverstein 34). In fact, “exclusivity, in and of itself, brings very little luxury value to the American luxury consumer” (Myth). Many marketers are beginning to harness the economic potential the middle class market presents. Some firms chose to increase distribution, despite the risks such a strategy presented: lifting constricted supply may erode brand equity.

Traditionally, luxury goods were sold in boutiques in limited cities across the world. As physical embodiments of luxury, these lavish and extravagant stores created an experience that was once just as important as the purchase itself. Creating the perfect shopping environment has always been of primary concern for luxury brand owners. The ambience and location must complement the brand.

However, boutiques fail to reach the growing market that wants convenience but still demands luxury. Distribution expansion does risk tarnishing brand image, but not as much as would lower prices. Major luxury brands have existed for so long, that their luxury status is ingrained in the consumer’s mind. “Brand awareness is now strong, so we think we can go more national,” Swanson of Gucci says. “We have seen the demand, the economy, and activity are really good in spite of the weak dollar -- and demand has been
strong for high-end products." To meet the growing demand, more firms should integrate the Internet into their marketing mix.

**WEB**

The Web as a channel of distribution generates a variety of opinions. Advocates recognize e-tailing as a powerful strategy to increase sales. Although websites are becoming more sophisticated and successful, many firms hesitate to sell luxuries online. The latter group argues that consumers will not purchase such high-ticket items via the Internet without first seeing them. Most importantly, they assert selling luxury goods on the Internet diminishes their cachet. However, with time poverty rampant, websites offer a quick, 24/7 shopping experience. Shoppers do not have to visit large cities nor feel intimidated in flagship stores.

Of course it is hard to transfer the expert design and luster of both the store and the product on a two dimensional computer screen. Whereas a beautiful store and helpful salespeople can seduce consumers, the consumer has control online. But does this really translate into a complete lack of control for the firm? Can it not dictate what the consumer sees? Avoiding the Web may have been appropriate if the luxury market and the lifestyles of its consumers stayed stagnant. But time constraints and increase market outside metropolitan areas point to the Web as an appropriate distribution medium.

Today, Americas are more comfortable than ever browsing and purchasing online. As of March 2005, an estimated 70% of US adults use the Net as an information source when
shopping for products and services. This figure is up 10% from October 2003. Additionally, Forrester Research conducted a study on e-commerce transactions and found the percentage of online shoppers who are millionaires is greater than the percentage of the US population who are millionaires (Exhibit 7). By 2010, e-commerce will have a 14% compounded annual growth rate over six years. Although this includes all of the Net and not just transactions in the luxury market, these figures demonstrate a changing attitude about shopping online.

THE DOT COMS

Companies like LVMH, Gucci, and Burberry are all on the net. LVMH distributes through its subsidiary, E-luxury.com. Gucci and Burberry distribute through Saks.com and Neimanmarcus.com as well as their own sites. Vuitton.com, although flashy and extravagant, offers superior functionality. There is a seamless virtual transition—the site exudes opulence.

ARE THE DOTCOM’S SUCCESSFUL?

Quantifying websites’ bottom line contribution presents some problems. The effect of brand recognition from online browsers is difficult to measure. In addition, companies are reluctant to share sales generated specifically from their websites. However, Web performance can be examined by looking at the overall division that encompasses the internet as well as firms that only sell luxury online.
**TIFFANY.COM**

In the US, Tiffany distributes 2,800 products through tiffany.com for purchase. While the company does not provide the exact portion of sales that come from its website, their annual report exhibits total mail, telephone, or Internet orders received. Although this figure is only up 10% from 2002, the firm cites a decrease in telephone and mail orders over this time period. Therefore, the real percentage of Internet orders must have increased, as this figure is discounted by the two other channels. In addition, the average Internet order increased from $180 in 2003 to $210 in 2004.

**NEIMANMARCUS.COM**

Neiman Marcus’s 2004 annual report cites the Web “as an opportunity to connect with vastly underserved markets via an online environment that reflects the sophistication of our stores.” In addition, the firm asserts that “the Internet is the cornerstone of [the firm’s] fast-growing direct-to-consumer efforts.” Indeed it is—Web sales grew over 50% in 2004, totaling $242 million. In the future, Neiman Marcus plans to expand merchandise offered on NeimanMarcus.com as well as convert BergdorfGoodman.com from an information to a commerce site.

**ODIMO.COM**
Operating since 1998, Odimo, a luxury e-commerce site, owns ashford.com, diamond.com, and worldofwatches.com. Ashford.com sells brands such as Waterford, Baccarat, Prada, Fendi, Gucci, TAG Heuer, and Cartier. Diamond.com offers the quintessential luxury item—jewelry. WorldOfWatches.com sells a variety of brands such as Cartier, Gucci, and Movado. Although Odimo is not a traditional luxury firm, sales trends will indicate how comfortable the consumer feels buying luxury online and if there is an increasing demand. Despite operating at a net loss since inception, operating expenses are cited as the cause rather than a lack of demand. In fact, 2004 net sales increased 25.3% to $52.2 million from $41.7 million for 2003. Approximately $4.7 million, or 45.0%, of this increase resulted from higher luxury goods sales. In addition, 2004 number of orders increased 33.8% to 155,840 from 116,440 for 2003. Odimo attributes this growth to an increase in new customers as well as increased sales to existing customers.

On the other hand, many firms have made little or no attempt to expand virtually. Rolex allows its consumers to browse but not buy. When you first enter the site, a message alerts that genuine Rolex watches are sold authorized stores only. Limiting the consumer even further, Prada only has a welcome screen, displaying their logo and some advertisements. No links lead to information, not even pictures or store locators. If the Web has such potential, why the opposition? Resistors cite their target demographic is not online and brands will be jeopardized.

**Online Consumer?**

Traditionally focused on the extreme wealthy, firms preferred personal interaction with
customers. Salespeople help forge a strong relationship, creating an emotional attachment to the label itself. However, as luxury access trickles down into the middle class, flocking to brick and mortar stores takes up too much of their already condensed time. In 2004, nVision Research conducted a study and found Websites are considered a viable purchase channel for many luxury goods: one in three luxury consumers would buy a watch online and one in four say they would buy jewellery. According to a study by Shop.org and Forrester Research, online jewelry and luxury sales are expected to increase 39% in sales this year to $2.8 billion. “95% of clients like the anonymity and time-shift of using the Web,” Swanson of Gucci argues. “Despite views to the contrary, you can provide a luxury service online--even clients who have easy access to our stores often like online shopping.”

Women ages 25 to 42 predominately buy luxury online—however, men’s share is increasing. Gender independent, most of these consumers hold at least a bachelor’s degree and earn over $60,000 a year. (“E-tail”). These consumers demand the highest level of service and information online as received in stores. In response, e-tailers such as Neiman Marcus offer personalized online shopping—e-mails and browser suggestions based on purchases as well as instant customer service.

**The Virtual Brand**

Without a doubt, transferring brand image online while keeping the site easy and convenient represents a challenge. A luxury marketing consultant agrees: "The Internet enables a unique experience, but when you try to take the in-store shopping experience online without compensating for the things you lose, such as the sensory cues, you don't
truly capture the luxury experience."

Firms that have taken the Internet risk, however, demonstrate virtual translation is achievable. Gucci, Tiffany, and Burberry all have sites that exude luxury. Through technological power, webmasters crafted sites that are not only attractive, but are easy to navigate and purchase. Integrating chosen music, pictures, and links allows the firm vast control over brand messages. In the late 1990’s, when luxury first started going online, sites were much too lavish. They took too long to load and check out was difficult and questionably secure. Now, websites are better programmed to load faster and offer maximum credit card security.

Without a doubt, trade off between appearance and utility exists, but not enough for firms to avoid the Web. Gucci’s Swanson believes:

“In the early days, we were told by some of our competitors that ‘the clients just want to buy when shopping online, so don’t worry about the brand image stuff,’ but we have always felt that it was essential to meet our brand’s standards in terms of image, experience and service, whether online or not. So maybe you do lose a few sales, but you continue to build your brand rather than seek short term advantage […] we get emails from online clients saying [visiting gucci.com is] just like visiting a real store, that’s my perfect accolade.”

In addition, there is more to the purchase than the site itself. The servicing, packaging, and delivery of items must also complement the brand. Tiffany.com offers next day shipping—when the product arrives, it’s wrapped in the same paper and bow as in the store. Most e-tailers offer a lenient return policy, eliminating a usual barrier to online purchases. In effect, Websites have the potential to flawlessly capture brand image, serving as an extension of service and virtually embodiment of the brand
Firms that sell online recognize the changes in demand and cater to them. Price, not access, is now the main barrier, still maintaining an air of affluence. Allowing all to browse also creates an aspirational effect—those without money can still look through the site, and maybe remember the brand when their financial situation is improved.

Although they may seem sensible, firm apprehensions is built on obsolete market ideas. At a 2003 conference on luxury, one anonymous executive reported, “There are more and more young consumers with more money…and yet, traditional luxury products are loathed to abandon strategies that have worked for them in the past. The transition must happen” (Swanson of Gucci).

However, some very real concerns do exist that should not be overlooked. The firm must possess the infrastructure to go online and meet demand. Processing and shipping in the promised time from is vital. A return policy, customer service, and secure transactions help eliminate traditional barriers of online shopping. If any of these essentials are missing, the firm is bound to fail.

The above concerns represent the very fundamentals of going online. Successful layout and design depend on the firm’s creativity—site management relies on key employees. No doubt it is a big investment. However, the benefits far outweigh the risks. Despite rudimentary obstacles, previously launched online luxury sites exemplify that online sales strengthen brands more then they damage them.
CONCLUSIONS

More and more consumers are willing to pay the price for the Hermes scarf, Gucci bag, or Celine pants. They know these names and the quality they can expect. Purchasing online provides a necessary convenience for the modern consumer. Just as boutiques are physical embodiments of the brand, websites are virtual embodiments. Representing an extension of a firm, sites reach the new, growing market.
EXHIBIT 1

The World's Leading Luxury Goods Companies – Sales of Luxury Goods 2002

EXHIBIT 2

Mean family income by quintile and top 5%, 1966-2003 (2003 dollars)

Source: The State of Working America 0204/2005
EXHIBIT 3

Share of aggregate family income received by quintile for 2003 (%)

Fifth Highest, 47.64
Fifth Low est, 4.06
Fifth Second, 9.59
Fifth Middle, 15.46
Fifth Fourth, 23.25

Source: US Department of Commerce

EXHIBIT 4

Mean Disposable Household Income 1990-2015

US$ per household

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Source: National statistical offices, Euromonitor
EXHIBIT 5

Household final consumption expenditure (constant 1995 US$)

Source: US Census Bureau

EXHIBIT 6

Consumer Credit 1998-2002

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Source: Euromonitor, Federal Reserve Statistical Release

EXHIBIT 7

E-commerce Transactions Forcast

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<td>2004</td>
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Source: Forrester Research


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