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Taking stock of 2020

1.1 A year 2020 swept away by the Covid-19 wave

The first quarter of 2020 will probably remain as a **staggering anomaly** for a long time yet. In summary, slumps in turnover were confirmed in all regions as the virus progressed and lockdowns were successively introduced. Then came a recovery that is geographically misshapen, due to the lack of flow of international tourists, the varying speed at which the virus is dying out in different regions and, more generally, quasi-social effects implying that certain populations have the capacity to resume their consumption ultra-quickly in post-crisis periods (the Chinese and Americans, for example) whereas others are more reticent (Europeans, in particular).

Numerous brands held back when it came to upscaling their digital presence over the last few years and are today paying the price.

This crisis will have marked the acceleration of e-commerce significantly in all regions, although this growth has made a very variable contribution depending on:

- The **e-commerce** penetration of the brand or segment.
- The ability of the brand to rapidly and effectively set up **digital communication** campaigns.
- The ability of the brand to secure its delivery processes and **logistics channels** against the background of strict lockdowns in the majority of countries.

The combination of these three factors explains in particular how a Group such as L'Oréal has had a less chaotic year than some other Luxury Groups. Conversely, numerous brands held back when it came to upscaling their digital presence over the last few years and have paid the price.

In terms of business model, and as in every crisis, **the Luxury Maisons that use Wholesale channels have, on the whole, suffered more than those that focus on retail**.

For example, the Watchmaking & Jewelry and Wines & Spirits segments have suffered more as a result of destocking during the first part of the 2020 year. This power that Wholesale holds over distribution is less homogeneous in the Perfume & Cosmetics segment, where some players have made it through the crisis thanks to their strong e-commerce presence and/or high level of control over their distributors/resellers.

1.2 2020, a black or white year?

It now seems to have been almost officially agreed that the second quarter of 2020 was when the decline in turnover bottomed out; and the reasons for this stem automatically from the impact of store closures in Europe and the USA for a large part of the quarter.

The speed of recovery is dependent on 3 factors.

2 exogenous factors:

- The intensity of the economic crisis that is affecting and **will continue to affect the purchasing power of the middle classes and the "feel good factor" of HNWIs (High Net Worth Individuals)**.
- **The recovery in international mass tourism**, which is probably dependent on the arrival of a vaccine.

1 endogenous factor:

- **The ability of the Maisons to adapt to the new challenges** of the post-Covid world.

Regardless of which letter shape the recovery assumes (V, W, L or the Nike 'swoosh', etc.) it seems quite certain that this recovery will be different for each player, as some of the ground rules have changed.

We give a lot of credence to the K-shaped recovery scenario talked about by American economists, which has the merit of shifting from a game of forecasting, to advocating an almost certain scenario.

The vertical line of the K represents the wall that the world hit during the Covid-19 wave.

The ascending and descending lines of the K represent what might be commonly called the 'Winners' and 'Losers'. There **are two ways of being one of the Winners or Losers:**

- Winners:
  - Are in a **"sweet spot"** structurally (DNVB, for example) and are able to take advantage of this.
  - **Demonstrate agility** in adapting/pivoting their model and responding to the new ground rules.
- Losers:
  - Are in a **"hard spot"** structurally (airlines, for example) with little potential for reinvention.
  - **Lack the agility** to adapt/pivot their model and respond to the new ground rules.

It is interesting to note that in the K-shaped recovery model, the direction taken is determined at the start; the vertical line of the K, meaning the company's reaction and the work done by it during the toughest period of the crisis.

It is also interesting to note that the greater the distance from the vertical line of the K, the greater the inexorable divergence between the ascending and descending lines.

Will Luxury be spared? Probably, in its globality, but not without consequences for the weakest and less flexible Maisons.

1.2.1 How many « deaths » can be expected?

Covid-19 will first of all sweep away weak organizations with undeniable Darwinism. The same fate awaits companies that were weakened even before the crisis.

Will Luxury be spared? Probably and for various reasons:

- Many Maisons belong to Groups with solid balance sheets. The large independent Maisons generally have even more balance-sheet liquidity.
- As gross margin levels are (on average) relatively comfortable, sales, as weak as they may be, are able to absorb fixed costs more effectively than in other industries.

That is not to say that some (small) Luxury Maisons, who were already in difficult situations before the Covid-19 crisis with weak financial backing may not perish, though this will have more to do with the epiphenomenon than with the main tsunami. Looking back, we will see that the 2008 crisis, which did indeed have major consequences for some segments

(Watchmaking in particular), took relatively few victims in our Industry compared with other sectors.

1.2.2 Alive, but in what state?

Without envisaging any major defections, **the Covid-19 episode will probably constitute the greatest stress-test ever seen in the Luxury Industry**.

What is the Industry's capacity for resilience and what impact will there be on profitability levels?

The answers differ by segment and depending on the Maisons. Let's simplify the equation: on average, a Luxury Maison has a cost base that is fixed at 70-75% and an operating margin on arerage of around 20-25%, when things are running normally.

The equation therefore has two unknowns:

– **How sharply have sales fallen?**
– **What is the capacity of Luxury Maisons to cut their fixed costs?**

It is probably easier to answer the second question than the first as the fall and the recovery of sales will partly depend on external factors (new Covid waves, vaccines, economic crisis, consumer confidence, recovery plans, etc.).

A **reduction in fixed costs** is more **within the Maisons' reach**:

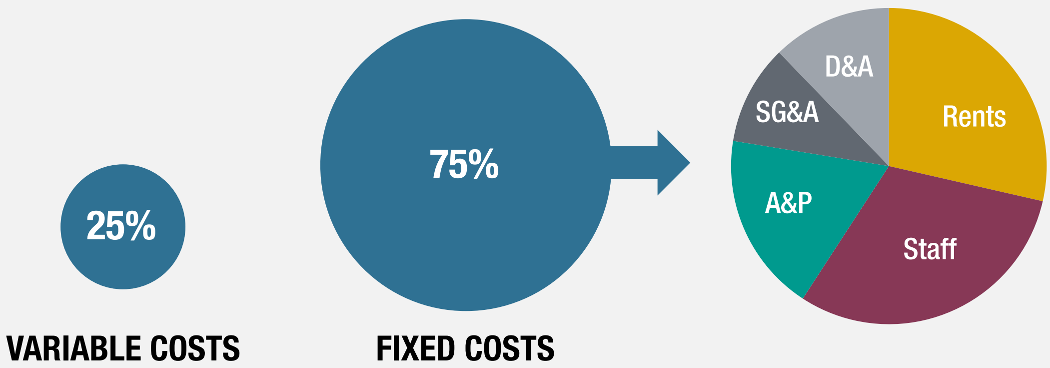
Rents: all the Groups since the beginning of the crisis have participated in rent negotiations with their landlords, discussing both fixed and variable rents (as variables rents often have a floor that is payable if turnover drops below a certain level). It appears that negotiations have been easier in Asia than in Europe and the United States. Some states have come to the aid of Luxury Maisons here, forcing (or strongly recommending) **landlords to agree to lower/suspend rent**. This is the case in France, for example, where the Minister of the Economy had asked large landlords to suspend rent for three months.

Wages: This is the most delicate and sensitive issue, especially in terms of communication. **The large Luxury Groups and Maisons have clearly adopted a policy of preserving jobs and wages**. Some, such as Chanel and Hermès, followed by LVMH and Kering, went even further by refusing State aid (partial unemployment for example) or even by paying part of the variable pay of their sales teams. **The scope for action is therefore quite limited**: reducing director/corporate officer pay and freezing new recruitment (which has an impact on costs with respect to the 2020 budget but no impact on the current existing cost base). The last quarter of 2020 will probably see reorganizations, which, in some cases, will lead to restructuring operations.

Communication: communication costs have seen a **considerable drop in 2020**. The first reason is purely mechanical owing to the cancellation of innumerable events (fashion week, collection launches, trade shows, Cannes Film Festival, etc.). Numerous Maisons have cut (or at best postpone) some large media communication campaigns. **Only digital communication could pull through this unscathed** as an omnichannel presence is still a precious leverage for a large number of players.

GRAPH 1-1

COST BASE OF A LUXURY MAISON (RETAIL)



REDUCTION POTENTIAL IN FIXED COSTS

	Rents	Staff	A&P	SG&A	D&A
Reduction Potential	10-20%	5-15%	30-50%	10-20%	Negligeable

Potential decrease in fixed costs between 15% and 20%
We retain -17.5% in our assumptions

2020 OPERATION MARGIN SCENARIOS BASED ON 2020 SALES DECLINE AND 2019 OPERATING MARGINS

2020 OPERATING MARGIN	2020 SALES DECLINE						
2019 OPERATING MARGIN	-10%	-15%	-20%	-25%	-30%	-40%	-50%
10%	15%	12%	8%	3%	-1%	-14%	-31%
15%	20%	17%	13%	9%	4%	-8%	-24%
20%	25%	21%	18%	14%	10%	-1%	-17%
25%	29%	26%	23%	20%	15%	5%	-9%
30%	34%	31%	28%	25%	21%	11%	-2%
35%	39%	36%	33%	30%	27%	18%	5%
40%	43%	41%	39%	36%	32%	24%	12%

The last quarter of the year will probably see reorganizations, which, in some cases, will lead to restructuring operations.

SG&A ("Selling, General & Administrative Expenses"): the scope for action is binary. Everything considered discretionary and non-key is cut.

By modeling these potential cost reductions, it seems that Luxury Maisons have a high level of resilience and can keep profitability levels in the green even during an annus horribilis such as 2020.

Let’s not forget that certain large Maisons are and will take advantage of the price elasticity of the sector by increasing the prices of "best-sellers".

1.2.3 Initial lessons learned

Let us view things from a different angle, looking at the lessons learned in the first half of 2020, which, as a whole, **confirm our macro-modelling but also show great variations, at micro level, in the reality experienced**.

GRAPH 1-2

Q1 2020 ASSESSMENT

FOCUS ON A DECREASE IN SALES AND A LOWER OPERATING MARGINS

	S1 sales on a comparable margin	Margin OP S1-2019	Margin OP S1-2020	Margin delcine	Stock market perf since jan 2020
L’ORÉAL	-12%	19,5%	18,0%	-2 ppts	+5%
HERMÈS	-25%	34,8%	21,5%	-13 ppts	+14%
LVMH	-28%	21,0%	8,0%	-13 ppts	+2%
KERING	-30%	29,5%	17,7%	-12 ppts	+2%
TIFFANY	-29%	17,6%	8,0%	-10 ppts	-13%
MONCLER	-29%	18,0%	-0,8%	-27 ppts	-5%
SWATCH GROUP	-43%	13,4%	-14,9%	-28 ppts	-20%
FERRAGAMO	-47%	13,3%	-19,8%	-33 ppts	-29%
TOD’S	-44%	1,3%	-36,0%	-37 ppts	-41%

In the first half of 2020, a Maison such as Gucci made operating profits of around €930 million, equating to an operating margin of over 30%, in spite of a marked drop in sales of 33%. In other words, that means that when the crisis was at its worst and having a very evident impact on its sales, Gucci still achieved a level of profitability that would make most major global businesses, regardless of sector, green with envy in a period of prosperity. **And Gucci is not an isolated case, as other large Maisons have remained largely in the black in the first half of 2020**.

Others, however, have suffered more and seen their results plunge into the red for several reasons:

- Most often because **their pre-crisis starting position was fairly precarious,** with profitability levels already low.
- Sometimes because **budget-cutting measures had little impact on the first half** and their effects will be felt more towards the end of the year.
- And, in other cases, because **certain players decided to record substantial depreciation (particularly of stock) in the first half of 2020.**

It will also be noted that **those most heavily impacted tend to be the independent Maisons,** for which there **might be several explanations**:

- Looking at margins, it seems fairly obvious that **your power to negotiate leases and media budgets** is stronger if you are LVMH than if you are a medium-sized independent.
- Looking at sales, one explanation might relate to the fact that **independent Maisons are often still over-exposed in their country of origin, which is generally a European country**. As an example, let us take certain Italian players, for whom Italy, and Europe more generally, remains a key market.
- Another explanation regarding sales might stem from the fact that **the independent players had fewer resources at their disposal to switch rapidly to an increased omnichannel presence during the crisis**.

Are we not, after all, witnessing the first signs of the K-shaped recovery scenario, with considerable bipolarization already between the Luxury players? It is highly probable that the ‘winners’ in the first half of 2020 will also be the ‘winners’ in the recovery as they will have retained their investment capacity (media, retail, e-commerce, people, board, etc.) to tap future growth. **Conversely, the necessary implementation of cost rationalization (unusual in the Luxury Industry) could be a lasting burden on those who have stumbled in the crisis**.

1.3. Initial impacts on the business model of Luxury Maisons

1.3.1 Luxury and e-commerce: a strategic alliance or a marriage of love?

Absolutely all Luxury Maisons and Groups praised **excellent e-commerce performance during the highest peak of this crisis**, with some even claiming three-figure growth (probably also because their starting points were quite low). In the overwhelming majority of cases, this did not, however, make up for the drop in physical retail. We must bear in mind that, **before Covid-19, e-commerce accounted for just 9% of sales** among Luxury Groups, with realities differing from one product category to another.

At first glance, these e-commerce sales appear to be the result of:

- **A knock-on effect** caused by the closure of physical retail. As a result, some Groups had noted far less positive e-commerce performance when physical retail reopened.
- **A psychological effect** that was particularly visible at the start of lockdown (I'm stuck inside, I'm spending hours on Instagram, I'm drawn to the bag I've been wanting to buy for months).

Although the **lockdown** has created **different consumption habits**, even the companies that have profited from this shift towards e-commerce are remaining realistic. **This acceleration will not remain at these levels forever**. This is especially the case for e-entertainment specialist Netflix, which welcomed more than 20 million subscriptions (a record) during the lockdown. Reed Hastings, CEO & Chairman of Netflix, stated at the time that he was remaining fully clear-headed about this illusory growth, asserting that this would lead to a record level of subscription cancellations and a very low level of recruitment once the lockdown ends.

For the Luxury sector this will probably have **several consequences**:

- The majority of customers will **return to physical retail** as soon as regulatory health conditions permit.
- Some people who made Luxury purchases via **e-commerce for the first time will have been won over** by this form of consumption and **will continue to make purchases this way in future, as an alternative** to bricks and mortar.
- Some Maisons will take heed of **the progress they can make** in activating **their digital presence** and improving their **e-commerce logistics** to accelerate rapidly in this area.

Ultimately, the Covid-19 crisis will undoubtedly accelerate growth in e-commerce penetration. However, this will not call into question the "No Channel" approach that first and foremost requires an interdependence and complementarity between digital and bricks and mortar.

1.3.2 Luxury and Wholesale: is it the end of the road or will this relationship continue?

The choice between Wholesale and retail is not always an option. First and foremost, you have to have the resources for a retail strategy, which is a major barrier restricting entry to the Luxury Industry.

As in all crises, Wholesale has been singled out: the destocking effect among distributors/retailers, the risk of discounts that could damage Brand Equity, payment delays… all of which can sometimes lead to ludicrous economic situations that see Luxury Maisons buying their own stock back from distributors (some Swiss watchmakers still remember the pain).

The Luxury sector has been largely retail-based for the last 30 years, although there are vast differences from segment to segment:

Fashion and Leather is now largely "**retail driven**" for the large Maisons. Some Groups have (again) considered **streamlining their Wholesale network** during the crisis. Is streamlining an already predominantly minority network akin to signing its death sentence? Probably not entirely, as some points of sale are still strategic. But we must not forget that, in retail, the cost of accessing the best locations is colossal. **This is one of the first barriers to entry into the Luxury sector. The choice between Wholesale and retail is not always an option**, first and foremost, you have to have the resources for a retail strategy.

Watchmaking and Jewelry is the Luxury segment that is **most at risk through its Wholesale trade** during crises for one simple reason: the key element in times of crisis is cash and Watchmaking and Jewelry is a cash-intensive business for a distributor/retailer. In crisis periods, these distributors and retailers will suspend all orders and tend to discount their stock to achieve a cash level that will allow them to weather the storm.

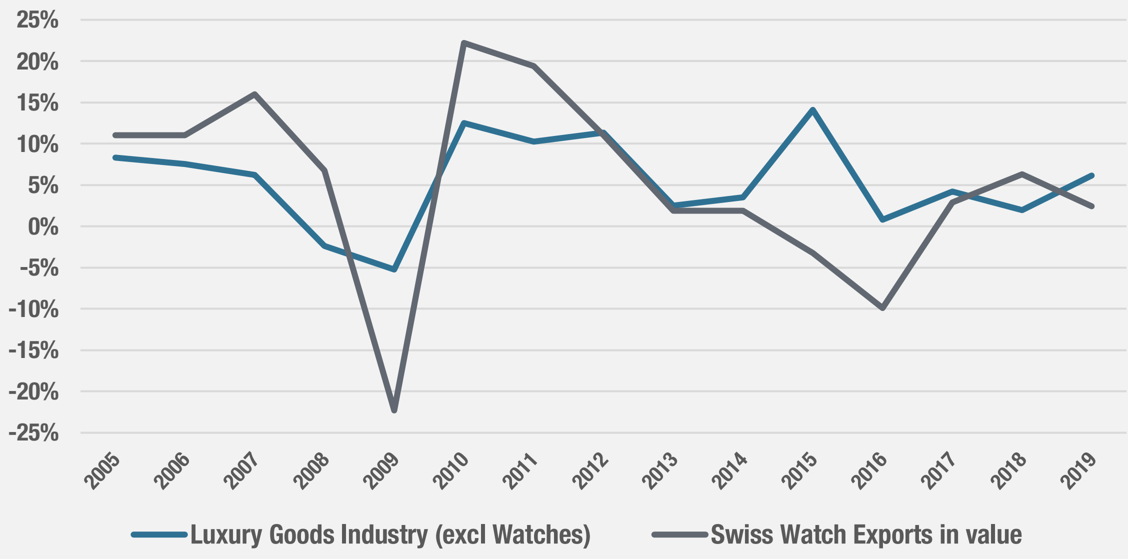
Some would say that it is better to navigate a crisis with a Wholesale network than with a network of 400 of your own stores. At the height of the crisis, this is probably true, but when looked at from the perspective of an economic cycle, there are four arguments that contradict this point of view:

- **Wholesale will lose ground more quickly** and more steeply under the effect of destocking.
- During the crisis, there is a **risk of massive discounts** on products, causing long-term damage to the brand image.

- **Risk of having to repurchase own stock**, which will have a devastating effect on P&L.
- Wholesale will take a little longer to relaunch, though it will be relatively strong, which may create bottlenecks in production.

Since the previous crisis in 2008, **large Watchmaking and Jewelry Groups have taken cautious steps towards a retail approach** (this transition was quicker in Jewelry than in Watchmaking, with retail accounting for 60% of Jewelry sales, compared with 30% in Watchmaking). The challenge here is less a question of the ability of Luxury Maisons or Groups to invest in retail (we only need to take a quick glance at the balance sheets of Richemont or Swatch Group to see this) and more a question of these Groups or Maisons believing that **they are capable of creating profitable single-brand points of sale that generate sufficient traffic on their own**. Some initiatives have been launched over the last few years, including the TimeVallée multi-brand concept developed by Richemont and operated by partner retailers or the decision taken by Audemars Piguet to transition to 100% retail distribution with a mix of own stores and VIC lounges in strategic locations. The various options in terms of Wholesale strategy for these Luxury Maisons will be addressed later in this study.

GRAPH 1-3
THE AMPLIFYING EFFECT OF WHOLESALE ON THE CYCLE



In the Wines and Spirits segment, the question of stopping or continuing with retail has different parameters as the sector is **at the early stages of its retail transition**. **The Industry is used to the structural impacts of destocking and restocking**. It is very unlikely that Wines and

Spirits will **change its model** post-Covid-19 and decide to take a sharp turn towards retail, as this change would be met with two obstacles:

- The unbelievable network of distributors/resellers in key areas (who would be willing to cross their city to buy a bottle of Champagne when they can find that bottle in five shops (supermarkets or wine shops) within 500m from their house?).
- The on-trade will remain structurally Wholesale.

However, Covid-19 is set to mark **an acceleration in three trends** as part of a phenomenon seen more as D2C ("Direct-To-Consumer") than retail:

- The desire to **acquire customer data**.
- The desire for **Prestige categories to increase their own distribution channels**.
- The desire to **develop innovative e-commerce solutions**.

We will provide further details of this strategic question later in the study, when we discuss the specific features of each Luxury segment.

However, Covid-19 is set to mark an acceleration in three trends as part of a phenomenon seen more as D2C ("Direct-To- Consumer") than retail.

Perfume and Cosmetics is probably **the sector in which some stakeholders have found the most effective solutions**. Although this segment is by and large **dependent on Wholesale**, especially in Europe (specialist distributors such as Sephora or Douglas, perfumeries in some countries), **however the Covid impact has been fairly limited** (“only” -11% for L’Oréal on their sales during the first 2020 quarter). Some will say that this is because mass retail (for mass market products) or pharmacies (for active cosmetics) remained open, but even the Luxury divisions recorded a respectable performance despite their high level of exposure to Travel Retail.

The explanation for **this resilience rests, in our opinion, on two factors**:

- **Digital presence** and the ability of these brands to launch wide-ranging and efficient e-commerce communication campaigns. At L’Oréal, e-commerce was up 65% in the first semester and now accounts for almost 20% of sales (i.e. a growth contribution of almost 12 percentage points at Group level over H1).
- **Negotiating power** and the quality of relationships with distributors.

To prove this, we propose a little game based on the results presented by L’Oréal for the first semester: search for the number of occurrences of the words ‘destocking’ and ‘ecommerce’. We know your time is precious, so we have given you the results:

– ‘E-commerce’: 22 occurrences.
– ‘Destocking’: 0 occurrence.

We can also see that in areas in which e-commerce has the strongest market presence (China, United States, United Kingdom), it has, in some cases, compensated very significantly for low Wholesale sales (bear in mind that the mark-up effect means that the direct sale of a product is the equivalent of 2-2.5 sales of that same product in a Wholesale setting).

The Covid-19 pandemic will probably not spell the end of Perfume and Cosmetics resellers, but **could create new serious competitors for them, i.e. the brands themselves**, via their own e-commerce channels. This acceleration of the digitalization of this sector will be addressed later in the study, in a specific section dedicated to this market segment.

1.3.3 Long-term impact on ROCE for Luxury Maisons

Europe will be the big loser.

The ROCE ("Return On Capital Employed") could be **one of the indicators that is affected in the long term** for Luxury Maisons with strong retail penetration (Fashion and Leather, Watchmaking and Jewelry to a lesser extent and, more generally, large retailers with globalized networks).

Over the last 30 years, we have seen **three retail investment waves**.

– **1990-2010: Increase in retail approach in the Luxury sector**, primarily in Fashion, with large-scale openings, especially in Europe, in the United States and in Japan.
– **2005-2013: expansion in China** with widespread opening of new stores in China (Mainland & Greater).
– **2013-2020**: less intensive rate of new openings, **streamlining** (closure of nonprofitable boutiques), lots of **renovations/extensions**, especially in Europe (see permanent scaffolding and fencing in Place Vendôme and Avenue Montaigne for the last five years).

These various phases were intended as a means of meeting the need to serve clients all over the world, including by following them wherever they go, which was the idea that launched the Travel Retail boom. In terms of this channel, which is suffering heavily due to the current situation, we will attempt to provide some crisis recovery trends later in the study.

This rampant investment logic in retail could be called into question once the pandemic has passed **by two phenomena**, one short-term, one more lasting:

- **Short-term: the weak flow of large international travellers** (leisure & business), which is set to continue well beyond the end of the lockdowns and this sanitary crisis. Let's quote Augustin de Romanet, ADP CEO (Paris' airport) who anticipates a return of air traffic in Paris to the 2019 level "between 2024 and 2027".
- **Structural: the refocus of Chinese consumer spending** in China. We will analyze the causes and consequences of this phenomenon below.

While these trends are continuing, there will be a need not only **to increase investments in China** (OPEX and CAPEX) but also, and above all, **to consider streamlining (drastically, in some cases) costs** in areas affected by the loss of Chinese tourist consumption. Europe will be the big loser. Some areas of Southeast Asia, which are highly dependent on Chinese customers, could also be affected in the long term.

The first stage of this streamlining will see cuts in discretionary spending (A&P "Advertising & Promotion", some SG&A, "Selling, General & Administrative Expenses") and maybe in sales forces dedicated to Chinese customers. The second stage, which is more radical, will look at the density of the retail network, and may lead to **POS closures**.

This transition effect could, therefore, have a lasting negative impact on the ROCE of Luxury Groups and Maisons, especially given that it will be linked with other consequences of the crisis, which will be addressed below.

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Beyond 2020, everything will speed up

Among all the speculation, there is consensus on one point: the fundamental shifts initiated before the crisis will undergo **sharp acceleration in at least four areas**.

- **China's domestic market is growing much more quickly than expected** and customers are set to evolve – this will bring local consequences for the products and distribution, as well as governance and branch processes.

The recapture of local customers is becoming an absolute necessity in the rest of the world.

- Beyond e-commerce, the digital acceleration will be indispensable to allow Luxury Maisons **to get to know their customers and personalize the overall experience**.
- **In markets suffering from post-shock trauma**, there is no doubt that position statements are becoming more necessary than ever in terms of the **"search for meaning" and "sustainability"**. Yet Luxury has not yet reached this stage: while Groups are getting organized and brands are reflecting, **the discourse will need to** go beyond corporate statements, **it will need to strike a chord with the customers themselves**.

2.1 China: playing at home with customers keen to buy

The share of Luxury purchases made by Chinese customers in China looked set to rise from 25% to 50% of the overall Chinese purchases.

Unless disaster strikes, **Chinese customers will remain the number one Luxury clients for the next five years, and mainland China will establish itself as the world's leading luxury market**.

In 2008, Chinese customers only represented 12% of the Luxury market, they exceed 33% in 2019.

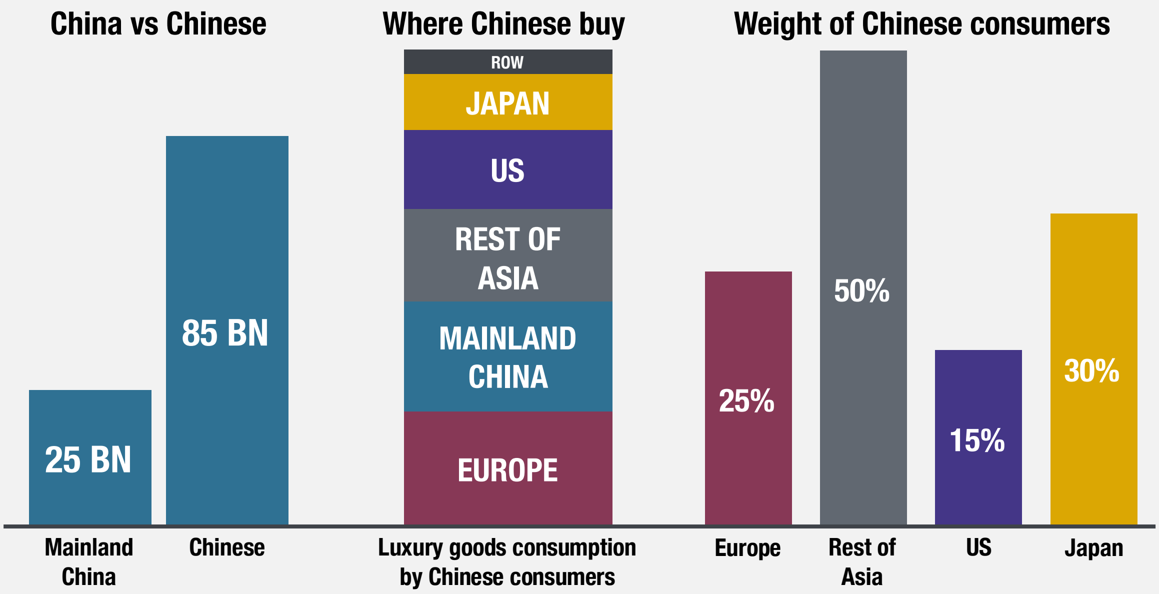
Pre-crisis estimates pointed to this figure rising to 45% by 2025, on a growing global market.

Over the same period, the share of purchases made by Chinese customers in China looked set to rise from 25% to 50% of overall Chinese purchases, essentially under government pressure to re-localize purchases and the associated economic benefits.

But with the brutal standstill of travel in 2020, this development is set to speed up: while China is not going to claw back all of the 75% of purchases made abroad, but everything points towards **a significant repatriation in purchasing towards the domestic market** – undoubtedly in line with the 50% long-term objective.

GRAPH 2-1

THE SECTOR'S DEPENDENCE ON THE CHINESE CUSTOMER



The emerging view is one of a domestic Chinese market shifting from 25% of 33% of customers (or an 8% total market share) to 50% of 45% of customers, or a 22.5% share. This represents growth of 280%, **reaching 55 to 60 billion euros altogether**; a step on the road towards the 80 billion euros in the United States. And when this change was previously expected to occur by 2025, it will, **in all likelihood, now emerge as early as 2021/2022**.

On the other hand, foreign purchases will collapse without necessarily **being totally offset by domestic purchases – apart from very few leaders**. Regarding the global Luxury market, the Chinese market will grow but the overall share of Chinese customers will decrease.

2.1.1 The many and changing Chinese consumers

We were already aware of the complexities of Chinese customers: they possess little loyalty to brands, but are loyal to Luxury, they are ultra-digital but committed to stores, individualists in the collective, sophisticated and logo lovers, nationalistic but different in one city to the next… **this complicated profile is not set to get any simpler**.

Yet four accelerations seem to be emerging as a result of the lockdown:

//// **Digital or life**: as e-commerce has not exploded for the Luxury sector in China (in any case apart from the Beauty Industry, and even if it grew by 400% on JD.com, it was starting from a very low pont), the "**No-Channel**" approach (a fully consistent, **silo-free and fluid omnichannel**) has remained the only means for brands to maintain contact with their customers. **Immersive digital experiences** (from "Live Sales" to digital Shanghai Fashion Week and specific brand content) have welcomed record audiences, further embedding the need to feed the digital appetite of Gen Zers and Millennials. The various interviews we held confirm our belief: **this is not to the detriment of stores, but complements them, accentuating the desirability of the brand** and its cultural impact, in preparation for a large-scale return to physical retail – the social significance of shopping in China is still difficult for the West to understand.

This complementary nature is indeed even an issue for e-commerce: JD.com uses luxury brand boutiques as delivery platforms, so the brands' ability to offer a good digital service comes from the physical network…

//// **China Pride**: within a political context in which nations are looking inwards (if only due to the travel ban), **Chinese nationalism is not set to decline**. Having been stoked for the last five years, this sentiment has been amplified in recent weeks through victorious discourse on the country's ability to control the epidemic. The consequences of this, in the short-term, will include, as a minimum, **a guarantee that customers will, more so than ever before, be treated as VICs** ("Very Important Customers"). This will require **demonstrations of love** in various areas (communication, product, experience, customer treatment, etc.). The success of the Dior launches and the Vuitton show in Shanghai demonstrate the importance of giving special treatment to China.

Chinese nationalism is not set to decline […] This will require demonstrations of love.

//// **Sensible shopping**; Three interesting dimensions to this point:

- **The most traditional aspect**: the need for meaning, for a responsible approach. Chinese customers are a little schizophrenic in this respect: very concerned about air quality while ignoring all environmental considerations in their consumption, especially in terms of Luxury goods. **The feeling of a need for a safer and therefore more responsible world** was largely anticipated as a consequence of the Covid-19 crisis. This point is not specific to Chinese customers and we will come back to this later, but China, more than ever, is putting environmental concerns at the forefront. If there is ever to be a surge on this theme for Luxury, it is likely to come from China.
- **2nd dimension**: the return to a certain level of traditionalism? Are the strong performances of Bottega Veneta in China compared with Gucci and the record sales recorded by Hermès a passing trend or do they represent **a need to return to safe investments**? Are they faint signals? Or more simply the repatriation to China of travel retail purchases, being generally less audacious due to less mature customers?
- **3rd dimension: militant brands**. In a country where freedom of expression does not fit our democratic models, the rebellious spirit of Balenciaga, Gucci's zest for life or the coolness of Loewe are, in themselves, means of expression, but these undoubtedly take on even more powerful significance when they become **the main way of displaying your own values**. An additional reason for certain brands to be clear about their Brand Purpose.

//// **From "Luxury is life" to "life is THE Luxury".**

Eight weeks of lockdown for a population in which Luxury customers generally spend most of their lives outside their homes has led to two mindset changes:

- **Health and quality of life will be new Luxury frontiers**. The story was already heading towards these two aspects, and here too, we can foresee an acceleration. And with fairly far-reaching implications, as we are beginning to hear whispers that wealthy Chinese customers are ready to consider leaving the large metropolitan cities for a healthier life.
- **A boost for Home & Furniture**. Our conversations with Jiang Qiong Er, the founder of Shang Xia, confirmed that her customers are thinking very seriously about breathing fresh life into their homes. We also discussed this very informally with our Chinese

customers, who scoffed at the idea that they were becoming more European in this area. The sector was already simmering; there is no doubt that things will accelerate here too.

Health and quality of life will be new Luxury frontiers.

2.1.2 But what consequences will this have for the Luxury Maisons?

Faced with this strong growth of the Chinese domestic market, there are four priority areas to address:

//// In the very short term, **resizing Chinese operations**: faced with a level of traffic that is set to rise, the first priority will be **product availability**. Then **guaranteeing a quality experience** as a minimum in stores that are busier than normal (as we saw after the lockdown), with consumers ready to buy again (conversion rates have dramatically risen, exceeding 35% for certain mega brands). Finally **conserving the momentum** through communication pitched at the right level in terms of content and intensity.

//// The product dimension will **also undoubtedly need to evolve towards even more limited editions**, exclusive products, and pre-launch sneak peaks. One notable example is Prada at SKP-S (the amazing experience satellite store in the SKP shopping centre in Beijing). Decor and products are all exclusive. While the launch back in November last year was a resounding success, Prada used the lockdown to entirely reinvent its store so as to open a completely new space at the end of April 2020. They are now in their 3rd rotation and, like Vuitton who has adopted the same discipline, are showing remarkable performances.

//// Distribution: The existing physical network **will reach its limits in terms of experience if it does not grow**. A recent study conducted by Tofugear revealed that Luxury brand customers were significantly more loyal to brands in cities where there are physical stores. Yet "only" 60% of the Chinese middle-class lives in Tier- 1 and 2 cities... It will therefore be necessary to speed things up in order **to shift from "one-store cities" to "two-store cities"** in cities with high potential (Chengdu, Wuhan, Guangzhou, Nanjing etc.) and accelerate **new openings in emerging cities** (Guiyang, Ningbo, etc.). Some defections will undoubtedly allow certain brands to reclaim prime locations in preparation for 2023. However, to leverage this opportunity, significant investments are required **all within a strained CAPEX context** – those heavily invested in Europe are still far from being amortized. **A very precise strategy will be needed now more than ever**.

//// Lastly, and perhaps most importantly: **a cultural bridge** to be cultivated intensively. The demand of the Chinese market and the rhythm that it will impose w**ill transform the brands**

into tightrope walkers without a safety net. The slightest error could be fatal. **The slightest delay could be painful. The slightest lag will give a decisive advantage to competitors**. In this context, local branches will come under pressure and head offices may struggle to justify their added value and keep the minimum level of control required to maintain the discipline of a Luxury brand. Understanding Chinese culture is already the mission given to the branches. Understanding it enough to **adapt processes, resources and governance** is sometimes more difficult in a Paris-, London- or Milan-based head office with generally **no Chinese representation on its Executive Board**.

> **Understanding Chinese culture [...] to adapt processes, resources and governance is sometimes more difficult in a Paris-based head office with generally no Chinese representation on its Executive Board.**

The challenge posed by China is profound. Yet, we are looking at this optimistically, as an opportunity to adapt to a source of growth, which will be very welcome in the post-Covid-19 world. **But there is also a pessimistic view: a diplomatic crisis on the basis that "China will pay"**, exacerbated nationalist isolationism, a harder economic crisis than anticipated, boycotting of American, French and to some extent Italian products, etc. **This would be tragic for the Industry**, achieving nothing more than making the importance of local customers even more significant, customers who are already critical due to the absence of tourists.

2.2 Love your (local) customer as you would yourself

> **Local custom is not the miracle cure that will make up for this loss.**

2.2.1 « No plane, no gain »

Aircraft grounded. Quarantine policies in force... The tourism industry is going to suffer terribly, and this will have a direct impact on the Luxury sector, with the forecast of a strong market regionalization.

We can already identify the **big losers: Duty Free**, which represents two thirds of consumption by Chinese tourists, has been hit very hard. **Department Stores**, which represent 15% of consumption by Chinese tourists, but which sometimes generate well over half of their income from Chinese customers.

In Paris, the Department Store boutiques were almost exclusively visited by tourists, who also make up two thirds of visitors to the image flagship boutiques on Avenue Montaigne, Place Vendôme, rue du Faubourg Saint Honoré or the Champs Elysées. **Only those "local" stores,** on the fringes in St Germain or Le Marais, **could hope to reach 50% in terms of local customers**. Globally, the situation is the same in London, Milan, Tokyo, Seoul, Hong Kong of course, New York, Los Angeles... Fortunately, the situation is a lot less pronounced in secondary cities. **In Europe, the share in Luxury purchases made by tourists from outside Europe is estimated to be around 50%**.

But local custom is not the miracle cure that will make up for this loss. Here are some figures nonetheless: in 2019, the Luxury market grew by just 4%. Asian customers contributed 110% of this growth. American customers 10%. And over this period, European customers made a negative contribution of around -20%.

Business was also extremely quiet in most European capitals after lockdown. Chinese "personal shoppers" (European residents), fueling the "grey" market, or well-off customers via direct operations were often the biggest customers of Maisons who – with the survival of the local network at stake – have suddenly become less particular than they were prior to the crisis about these customers previously deemed undesirable.**The local clientele is therefore still a long way off from returning and a long way from providing the necessary level of business**.

In the United States, the market, which is highly local, is naturally more resilient. With great sectoral diversity, of course. The exodus of the most affluent from their second homes is permanent, but their desire to buy is no less real. And if the activity is maintained within the stores, it is also due to the massive use of "remotes sales", with customers buying at a distance - a practice that is more widespread in the country that saw the birth of distance selling.

Europe was therefore a local market in decline, even before the crisis, which was not the case in the United States. It is difficult to imagine that this trend will not be exacerbated in Europe, or that **the curve will not flatten in the United States**. The sector will therefore need to adopt a 'damage-control' approach in 2020 and undoubtedly 2021 as well, while waiting for the tourists to return... expected at best in 2022, without a return to normal, according to the IATA, before 2024.

2.2.2 Get to know customers before seducing them

The Direct-To-Consumer question will be more relevant than ever before.

In order to begin the quest to win (back) local customers, the first thing that is needed is to have access to them. Which is more complicated than it seems.

The sectors of the Luxury Industry are not all equal – with a Fashion and Leather Industry that has built enormous direct distribution networks, a Watchmaking and Jewelry Industry that still depends on its distributors for more than 60% of its sales on average, Perfume and Beauty that is just starting to open its own shops in Europe, and Wines and Spirits, which is not yet there, we can see that the complexity of the task will not be the same for all. As already mentioned, the **"Direct-To-Consumer" question will be more relevant than ever before**. Physical retail is far from the only answer: digital can also make a significant contribution here.

Connecting with the end client will be indispensable if the Industry is to control, at least to some extent, its destiny.

Connecting with the end client will be indispensable if the Industry is to control, at least to some extent, its destiny.

Once customer access is possible, two challenges emerge: collecting the data and using it.

The mega-brands are already making strong progress in this area. The majority of Maisons (those turning over less than 2 billion) have structures, means and resources akin to those of SMEs. And because they are Luxury Maisons, they also have **a historical culture of value creation centered around the product much more than around the customer**. Luxury invents customers' dreams. It does not aim at meeting any expressed need. Luxury does not have a customer knowledge culture as its value creation lies elsewhere.

However, in the age of data, of predictions, of Amazon, of Facebook and of their intrusive algorithms, **working local customers means understanding them**, knowing them intimately, staying on point in each and every interaction, and moving at the right speed.

The Luxury Maisons that have stores have infinite opportunities to collect data relatively easily. In addition, they have also deployed a wealth of **special treatments** for their VICs ("Very Important Customers") and jewelry "*Grand Vendeurs*" are an absolutely fascinating example of relationship personalization. **For the Maisons that have the information, the challenge now lies in using this information as effectively as possible**, and paying special attention to more customers, **beyond just the VICs**.

2.2.3 One to one

By preventing large gatherings, the Covid-19 crisis **has stopped, at least temporarily, a multitude of events** (trade fairs, shows, etc.) whose existence was already a matter of contention in terms of their **cost, arrogance** at times, continued pollution or usefulness.

These events went hand-in-hand with special customer treatment (generally VIC), which all ended up looking the same and risked leaving visitors somewhat fatigued. We will now have **excellent opportunities to build much more lasting, customer-centric relationships**.

//// **Adapted to the customer**: it goes without saying that an Asian Gen Zer does not have the same expectations as a middle-aged "WASP". **The future is in building tailor-made experiences**, which, when well-managed, give a truly **profitable** return on investment. Yet today, some Maisons, in their search for security, often still prefer a standard solution.

//// On brand: all the same – VICs invited to shows will all tell you the same thing. With the exception of the show and dinner (if there is one), **nothing stands out**. The Ritz suite is the same, the restaurant is the same... and the invitations to the X or Y show look very much alike, not to mention the show itself, which lasts less than half an hour.

> **During a fashion week for a large Luxury Maison, we suggested that two Asian VIPs, fashionistas under the age of 30, stay in a magnificent Parisian apartment, rather than at the Crillon.**

And what if this unique opportunity to connect with the customer was also an opportunity to share values, likes and dislikes, a world view? While the notion of meaning is taking on ever increasing importance and even resonating particularly strongly with Chinese HNWIs, **the time has come to engage in direct and constructive dialogue with customers** – dialogue that can and should remain light, inspiring, happy.

During a fashion week for a large Luxury Maison, we suggested that two Asian VIPs ("Very Important People"), fashionistas under the age of 30, stay in a magnificent Parisian apartment, rather than at the Crillon. They were able to organize a dinner party and soirée "at their place" and invite "their friends" to the event. A head chef, a DJ, hairdressers and make-up artists were all available at home. This made for a unique and unforgettable experience of Parisian life, on a controlled budget.

Of course, not all local customers are VICs. **But the whole challenge for Maisons is to ensure that their capacity to engage in more personalized discourse filters down to the lower thirds of the CRM ("Customer Relationship Management") pyramids**. The Maisons themselves have understood the stakes, addressing **two main challenges**:

//// The advent of CEM ("Customer Experience Management"): **putting the customer at the centre**. This is characterized by a message built on the basis of the customers' needs, their habits in terms of their interaction with the Maison and their interests in order to make their experience ever more personal. **This is important for restoring the local clientele's faith in brands they have sometimes cold-shouldered**, either due to stance or because they felt undervalued amid the perceived excessive presence of tourists, by offering this local clientele tailor-made experiences.

//// The spread of clienteling: personalization also entails personalizing the relationship, and how better to **nurture this than by providing personalized service**. During the lockdown in China, one of our customers told us that Luxury Maisons in their mall had succeeded in maintaining up to 40% of their turnover by cal**ling all of their customers, one by one, by phone or via WeChat**.

In Paris and throughout the world, there has been a real explosion in Remote Sales. These operations, set up both by brands and major department stores (in 3 weeks on the ground floor of Galeries Lafayette Haussmann), have admittedly helped provide service to a local clientele but also to certain tour operators. In European stores that are far emptier than before, but also in the USA, where the elite are often still taking refuge far away from city centers, [teams will have to adopt new approaches in a systematic way – and it will be necessary to train them, adjust KPIs and reorganize their work.

Winning back local customers is therefore only possible by adopting a rigorous customer data management policy, to which the Luxury Maisons will add a little touch of soul.

2.3 No channel: this time, this approach will truly be embraced

Some Luxury Maisons are already heavily engaged in this customer-centered approach. Here again, however, the disparities are striking, between the sectors, depending on the size of the market players or their appetite for the approach, for example. **Yet, Luxury is still lagging a long way behind the most advanced sectors**, and the current crisis has only exacerbated this, increasing the power of those at the forefront of this trend and revealing a vast gap in some areas of the Luxury world.

2.4.1 Digital takes a turn towards experiences

//// We have already discussed CRM ("Customer Relationship Management"), CEM ("Customer Experience Management") and data as a way of developing customer knowledge **and building close relationships. A must.**

//// E-commerce: yes – "Live Streaming": even better! **12% of the market in 2019 and growing steadily**. We have seen that, for the moment, the crisis has not had a lasting impact on the size of this distribution channel in China - digital laboratory - for the Luxury market (excluding Perfume and Cosmetics). Conversely, outside of Luxury, "Live Sales", for example, have boomed (10% of e-commerce in China, a market worth around 65 billion USD). "Live Sales" or “Live Streaming” are filmed sales. Unlike "Remote sales", one-to-one between a vendor and its remote customers, "Live Streaming" is one-to-many: the brand, supported by a KOL, presents its products to millions of customers. Skeptics will dismiss this as a return to teleshopping. But in 2019, live-streamed e-commerce grew by 71%, much more quickly than pure e-commerce. Just over 60,000 "Live Streaming" brought together 400 million users on Taobao (an 80% share of the Live Sale market). By February 2020, the number had doubled compared with the previous year. At the height of the Covid-19 crisis, one extraordinary sale (which gave attendees the opportunity to buy a ticket for space) welcomed some 49 million viewers!

This demand for interactive, **experience-based e-commerce** is interesting as it opens up **a new alternative to commercial websites** while possibly promoting **local activity** as well: this is precisely the reason why Icicle (a Chinese ready-to-wear brand) has set up studios (equipped and dedicated 10 m2 spaces) in its 30 most performing stores to allow it to hold "Live Sales" aimed at a local audience. A very concrete way of winning over customers through an approach that combines both digital AND physical retail.

This demand for experience-based ecommerce is interesting as it opens up a new alternative to traditional commercial websites while possibly promoting local activity as well.

While Beauty brands have already made extensive use of this model, enjoying significant success, nothing that we have seen up to now is really compatible with the Luxury culture. But things are changing rapidly, and **Louis Vuitton’s live-stream attempt** on 26 March on the site Little Red Book (which could be reviewed) **certainly opens up a new path**.

//// **Experience –** A vast area that covers various aspects:

Improving the physical experience: anything that allows customers to have the product they want, where they want, when they want will be welcome (monitoring stock in real-time, simplifying transfers, etc.), and making the customer experience smoother (visit preparation, check-out, etc.) or improving the relationship should be prioritized – irrespective of whether this involves the front or back office (supply chain, in particular).

Creating experiences where the digital nurtures the physical: Luxury is emotional, and this emotion, far more often than not, comes from a smile, not a screen. The first response, however, from the brands: the race for content. We are working with a megabrand that in recent months has tripled its content creation. At the same time, this brand has significantly improved the quality of his content - convinced that this will widen the gap in terms of perception and therefore prestige.

Concerning that, the Industry still needs to stay away from the sometimes-gimmicky side that comes with digital tools in stores. Conversely, we must remain alert to the potential of 5G to further enhance the experience, its sensory nature and fascinating stories.

2.4.2 In the short term, the virus needs our full attention

Some people foresee radical and lasting changes in the way shops are organized to comply with new distancing requirements.

It is certainly true that, while the shadow of Covid-19 lurks, rigorous health measures will need to be taken, and we are already seeing this happen.

However, looking beyond the next few months, **we do not believe that store layouts will be changed permanently**, or that the size of stores will need to increase in order to widen aisles from 60/90 cm to 2.5 m. The previous health crises in Asia (SARS and MERS), did not change how these spaces are organized, though they were far smaller in scale. **They did, however, contribute to developing local health habits** (wearing masks, hygiene measures). On this basis, we think that these **more responsible practices, coupled with the resilience** of our customers, will allow us to return to better controlled working methods, but which are at least similar to those that we are familiar with today in Luxury boutiques.

2.4 Purpose in every sense

It is not possible to read an article without stumbling upon the issue of a “post-Covid-19 world”, where we should “ask ourselves some profound questions” to prepare for a “sustainable and responsible” future.

2.5.1 A responsible and authentic approach is crucial

Concrete and tangible statements [on CSR] in boutiques, the venue for 90% of transactions are... non-existent.

Luxury Groups have been working on this for a long time. Although a regulatory obligation for listed Groups, we see companies addressing CSR ("Corporate Social Responsibility") with undeniable gravity.

In the past, **the majority of initiatives** have essentially been implemented at Group level (i.e. at the level of the main communication bodies) **in an institutional way, and rarely aimed at the general public** (many Gucci customers are not aware of Kering). **Conversely**, when we “come down” to brand level, the statements made are less systematic. And here luxury is lagging behind: just look at the TV commercials in France in September 2020: everyone is "responsible", "respectful", "sustainable".... Some companies are taking a stand (Gucci in the Fashion sector), some are more discreet, others are anecdotal, and for many companies, they remain unheard – especially in “hard luxury”. It may well be smarter to stay quiet when there is nothing to say but i**t will be difficult for companies to exclude themselves from the discourse for too long**.

More surprisingly, even where the expression of this world view is very clear in corporate communications, **concrete and tangible statements in boutiques, the venue for 90% of transactions are... non-existent**.

Yet, the brands have their arguments: Fashion may well be a polluting Industry, but Luxury comes out rather better in terms of the three aspects of CSR.

//// Economic: the brands make a significant contribution to the countries in which they operate – relatively high wages, responsible subcontracting and supplier relationship policy with (relatively) good traceability.

//// Social: the brands have a **high level of female staff**; they contribute to the **survival of a large amount of expertise** (see "*Métiers d'Art*" at Chanel) that would otherwise disappear. These companies are committed to **inclusivity and responsibility** (Kering was among the first company to refuse to use child models in 2019 and/or models who are too skinny).

//// Environmental: this is a much bigger challenge. Yet the brands prioritize **renewable raw materials, provide structure for sectors** that need it (for example, cashmere), extend initiatives across at least some of their collections or capsules, **strictly regulate their sourcing activities, and above all, generally offset their carbon footprint**.

In a world where nobody is perfect, Luxury Maisons have nothing to be ashamed of when it comes to what they have already undertaken.

But the challenge is much more complex.

In a world where customers are both more engaged and fickler, commitments can no longer be focused solely on the product and a storytelling of craftsmanship.

Luxury is highly visible: its adverts fill screens, its boutiques are at the heart of urban landscapes, its products star in photos in celebrity magazines, its shows feature in the news. **By its very nature, it provides a world view**, creates new dreams, shapes the profile of imagined happiness.

This world view goes far beyond the simple CSR message: **it is a system of values** that may seem superficial, but which have a profound impact. **Luxury is vast, and therefore multifaceted: the timelessness** of a watch that calls out to be passed down is at odds with the **ephemeral nature** of a fashion collection.

The question of meaning was already present before the crisis, and although some collections or campaigns displayed almost militant biases (Gucci, Balenciaga, Dior for women), brands did not provide much clear communication about a system of shared, strong, distinguishing values – today, **the famous "Brand Purpose" is not clear for many Luxury Maisons**.

Yet in a world where customers are both more engaged and fickler, commitments can no longer be focused solely on the product and a storytelling of craftsmanship.

To better connect with their clients, **brands will need to perform a three-way exercise** involving:

//// **Introspection**: to succeed in the delicate issue of **defining their "why"**. This (interesting) exercise aims to draw up from deep down within the brand that special something that will make it inspiring, exhilarating, uniting, different... as a good "Brand Purpose" does not lecture and is not overly serious.

//// **Projection**: to spread this why through everything that is visible to the public: the products, and more generally the signature of experience in **all interactions** with the brand, whatever the medium. We call this **defining the experiential signature**.

//// **Percolation**: to ensure the message reaches customers. This begins with continual staff commitment so that each employee **makes these fundamental values their own**. This is a "mandatory" step towards the customer. Formalizing, as well as raising awareness of, providing training on and sharing this "Brand Purpose" will guarantee the success of the approach. This must be driven by every part of the organisation, from the CEO and Artistic

Director to the security guard who opens the shop doors, whether in Beijing, Rome or Mexico. This is part of a permanent strategy. It is not a one-time measure. For it will be over the long term that we will evaluate the strength of Luxury Maisons.

And it would be a shame if Luxury, which ultimately has so much to say, was not at the table. It may not be able to overcome the issue that makes it so contentious, its social stratification aspect, but the brands will undoubtedly be able to strengthen their aura by taking it beyond their history, exquisite collections and beautiful images.

2.5.2 Towards a happy and creative world view

If the desire for life existed before Covid-19, then the crisis has only increased this: a fantastic creative opportunity for Luxury.

Sustainability, responsibility, respect, humility. These challenges, these values, are important. That's a given. They bear a strong moral dimension that fits into the current discourse.

One of Luxury's primary missions is to be loyal to its demand for creativity. This is Luxury's raison d'être.

Morality may well be high on the list, but first and foremost Luxury is creative. And these two concepts are not necessarily incompatible; indeed, it would be very dangerous to pit them against one another. During one of the MAD Talks that we organized in April during lockdown, we interviewed Edouard Tétreau, a fantastic columnist who has written for Le Monde, Le Figaro and Les Échos. He reminded us that the First World War and the Spanish flu that followed it led to the Années Folles in France, to that explosion of creativity, that unbridled desire to live.

This creative and joyous energy that may follow Covid-19 would be an extension of this positive view that some Luxury Maisons have already committed to.

Even if the comparison to the *Années Folles* quickly reaches its limits, it resonates with current trends. The success enjoyed by Gucci over the last few years has, of course, come as a result of the talents of its Artistic Director (that notion of creativity emerges once again) as well as a colorful, cheerful, inclusive and vibrant world view. There is no doubt that Balmain has already distinguished itself these past weeks, both by its show on the Seine and by its colorful collections.

So, if the desire for life existed before Covid-19, then the crisis has only increased this: a fantastic creative opportunity for Luxury: creation is its core, where value is created. In order to stay with an overarching vision that covers the various segments, we can envisage greater creativity instead than a rather sad, albeit safe, contraction.

Long live color, life, hope. Although Covid-19 has made us collectively more aware of death, it has, at the same time, made us remember the value of life. Luxury, a reflection of our beliefs, will become an inspiring and colorful echo of this.