Luxury Goods Market: Trends, Financial Performance and Future Perspective

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Introduction and Market Structure

The luxury goods market represents a unique segment of the retail industry, defined by high-quality craftsmanship, premium pricing and targeted consumer experiences. As a market in an interconnected global economy, it has experienced various economic cycles, disruptions and scandals.

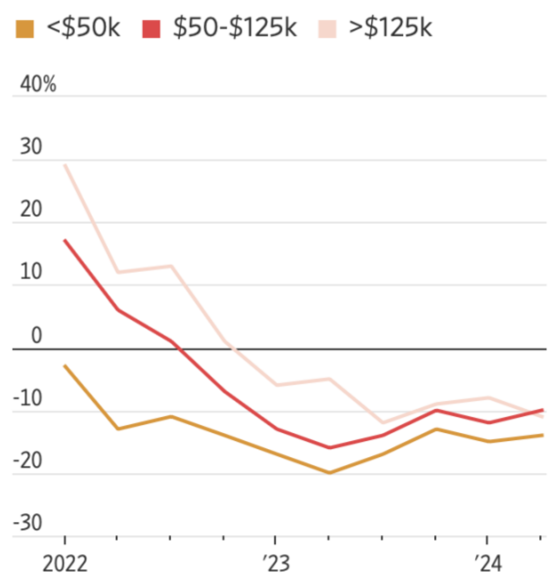
The market for luxury goods consists mostly of established brands as reputation, quality and brand value are important characteristics of companies that wish to operate in this segment. Many renowned brands are owned by others and held as a subsidiary. One such example is the market leader *LVMH Moët Hennessy – Louis Vuitton SE* with ownership in 75 subsidiaries, for example *Moët & Chandon*, *TAG Heuer*, *Loro Piana*, *Rimowa* and *Loewe*. Another example is the Swiss company *Richemont* with full ownership in *Cartier*, *A. Lange & Söhne*, *IWC*, *Montblanc* and others. The market offers a great product range from fashion, leather products, watches, and perfumes to beverages and appliances for one's daily life.

What is of particular importance is the need for luxury companies to balance online shopping experiences and in-store sales. This is due to the fact that customers are setting higher expectations in both spheres than in other types of retail. In addition, pricing strategies and market dynamics are not trivial since brands benefit from artificially created exclusivity and scarcity while having to find new ways to increase sales, profit margins and market share.

Challenges for the Luxury Goods Market

The luxury goods market has recently been put under pressure and is challenged by a changing environment. Most importantly, the sector finds itself in a sales slump and in times of stagnating or negative growth.

Figure 1: US Luxury Spending by Income Group

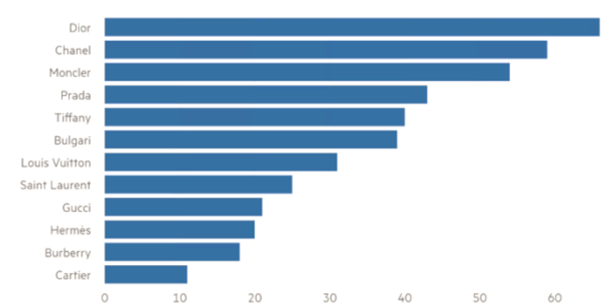


Source: Bank of America Global Research

Data from the *Bank of America* indicates that US consumers spend less on luxury goods than a year ago across all income groups. In 2022, income earners above $50k a year increased their spending by up to 30 % compared to a year earlier. This trend has now, however, reversed as all income groups are spending approximately 10 % less on luxury goods than 12 months before.

To an extent, brands are responsible for this decline in sales. As consumers are looking to save money, the prices for luxury goods are too high for further increases in spending on luxury goods. Under these circumstances, it is somewhat unfortunate for the designer brands that their pricing policies of recent years are now a burden on their revenue. This is due to immense price increases in the period from 2020 to 2023. In an analysis by *Bernstein*, one can observe these significant price surges. On the upper end of price hikes is the *LVMH* subsidiary *Dior* which increased prices by 66 % in this period. The market as a whole is now pressured to reverse this trend to offer products at the lower end of the price spectrum for the hesitant consumer who is affected by a tighter household budget.

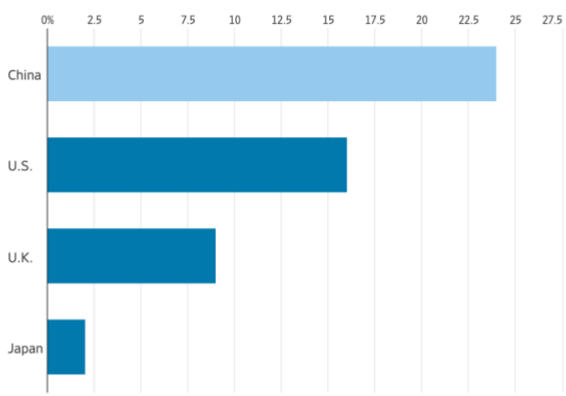
Figure 2: Price Increases for Comparable Products, 2020-2023 in %



Source: Bernstein

The sales of the sector have also been heavily impacted by consumer spending in China. The market in Asia is of utmost importance for the sales of luxury companies and has experienced a relatively unexpected slowdown as consumers have sought ways to reduce their spending on luxury goods. The financial performances of internationally operating luxury companies are heavily dependent on spending in China nowadays, a country that accounts for a third of sales in 2024 – up from only 1 % in 2000. The disappointing performance in this region is therefore difficult to balance out with other geographic regions. As a result, profit margins are under pressure and higher pricing policies are unlikely to lead to growth at this point as outlined before. Fortunately for companies, this development does not seem like a structural issue but rather a temporary shift of consumer preferences or purchasing power.

Figure 3: Average Markup Compared to Prices in France, on June 30, 2024



Source: Bernstein

Another troublesome development for luxury brands is reselling in the Chinese market. Producers of designer goods have difficulties preventing this "luxury good arbitrage" or exploitation of price differences across geographic regions. At the core of these price differences lie different markups for goods in different world regions. According to a *Bernstein* analysis, consumers in China pay an average markup of 24 % compared to the same products in France; thereby making China the most expensive market for luxury goods.

As a response to this price discrimination, multibillion-dollar businesses have emerged in China, such as the platform *Daigou* which imports a variety of products from European designer brands. Buying these goods at a discount in Europe whilst simultaneously claiming VAT refunds allows the platform to offer luxury goods in China for prices that are more than competitive. This flawlessly legal business practice attracts many Chinese customers considering that *Daigou's* sales rose by 23 % in the first half of 2024, whereas the luxury brands themselves had to endure a sales slump of 5 % over the same period. The reason for this success is a logical response to stagnating income growth; the offerings of resale platforms are a very economical choice as Chinese customers are looking to save money.

Effect of Recent Developments on Stock Performances

The mentioned developments reveal a grim outlook for the near future which investors take into consideration when evaluating investments in this segment. Hence, share prices have been under pressure this year. Many prominent brands are currently in the loss zone year-to-date, e.g. *LVMH* or *Kering* losing market capitalization of 17 % and 42 % YTD respectively. The overall stock market in this segment remains somewhat volatile as stocks like *LVMH* dropped sharply by 7 % after disappointing third-quarter results. Despite that, share prices benefited from hopes about a Chinese economic recovery which led to higher share prices of *LVMH* and *Kering* of 3.3 % and 5.2 % respectively following newly announced data that the Chinese economy did not lose as much drive as anticipated. Despite occasional stock surges, the performance of European luxury brands has closely mirrored broader economic trends in Europe and, notably, in China over recent years.

Market Anomalies: Hermès' Success and the Rise of Quiet Luxury

Nevertheless, there seems to be an anomaly among the European luxury brands. This anomaly is the company *Hermès* which seemed to have captured all of the $400 million that consumers have spent less on the other luxury brands. Therefore, the company could increase its sales by €440 million compared to the previous year, according to the *Bank of America*. Although this shift may not seem significant given the overall size of the market for designer goods, it is indicative that *Hermès* benefited from choosier customers and a "flight to quality" as a *Hermès* Chief Executive called it. This can be seen by the current preference of Chinese consumers for subtle luxury goods - which are partly on offer at *Hermès* - as opposed to products with big logo prints.

A fortunate trend, however, from the perspective of designer brands in the market was the viral fashion trend of "quiet luxury". So-called "quiet luxury" are luxury articles that do not attempt to display one's affluence but rather make use of subtlety with little or no branding. The trend arguably originates from video snippets on social media or the *HBO* series "Succession". This trend has caused disruptions in the luxury goods market and led to an outperformance of companies that offer "quiet luxury" by 23 % compared to companies offering "loud luxury", according to *DBS Bank*.

Outlook for the Luxury Goods Market

The current market environment may appear distressed and like a headwind for companies in this sector. The future, however, fuels hope for market growth. Overall, a significant growth of consumer spending is anticipated, for example a luxury spending increase to €2.5 trillion by 2030 and hence, €1 trillion more than in 2023, according to a report by *Bain & Company*. This spending increase could yield an annual growth of 4 to 8 % up until 2030.

In the near future, it is estimated that Chinese customers will regain purchasing power and will intensify their domination as the most relevant nationality regarding sales of luxury goods. Current projections show a growing contribution to global purchases by 2030. In this period, the share of luxury goods purchases in China relative to global sales for these goods will amount to 40 %. Therefore, it will be one of the most important local markets for luxury goods.

At the same time, younger demographics will be a gold mine for brands since it is estimated that Generations Y, Z and Alpha will account for 85 % of purchases by 2030.

To sum up these insights, one should not be misled by the current period of instability in the market for luxury goods and the implications that come along with reserved appetite for these goods among Chinese consumers. But what falls with the tide will rise with the tide and hence, the growing wealth in China and other countries is likely to lift the market to new highs in the foreseeable future.