

Opportunities for Action in Consumer Markets

# Trading Up: The New Luxury and Why We Need It

THE BOSTON CONSULTING GROUP



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In the history of man, there have always been goods reserved for the upper classes. In ancient Rome, the elite built lavish marble baths for entertaining friends and allies, while the masses waited in line at public baths. In late-eighteenth-century France, the aristocracy turned to saddle maker Hermès for the perfect seat, while commoners had to walk through wet and muddy streets.

But today we are witnessing a different phenomenon: the democratization of luxury. We define it as middle-market consumers selectively trading up to higher levels of quality, taste, and aspiration.

The democratization of luxury is occurring across a surprisingly broad set of categories, and it is destabilizing competition, creating new winners and losers, and offering new rules for brand strategy. Already, this force has transformed a score of markets. (See Exhibit 1.) Many more categories are ripe for the taking. The question for established marketers is, Who will be first to bring the new luxury to my category?

To understand this movement, you must first appreciate the differences between the new luxury and the old, as well as the powerful emotional and economic forces behind consumers' propensity to trade up and seek quality.

### It's Not Your Father's Luxury

Old luxury is expensive. Only the really rich—a small segment, typically over 50 and conservative—can afford it. The new luxury democratizes high-quality

products, making them available in many forms, at many price levels, and through a variety of retail channels; they are no longer confined to the upscale shops of Madison Avenue and Rodeo Drive. New luxury is so accessible that virtually anyone can get a taste of it with a \$3 Starbucks latte and a few moments in an inviting chair. It's less about conspicuous consumption and more about self-respect and emotional need.

New luxury is also more resilient. While exclusive luxury declined sharply in the recession of 2001, new lux-

### Exhibit 1. The New-Luxury Revolution Cuts Across Many Categories

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<b>Coffee</b>	Starbucks
<b>Personal care</b>	Bath & Body Works, Origins, "masstige" products
<b>Oral care</b>	Rembrandt, Crest Whitestrips, Sonicare, and other appliances
<b>Appliances</b>	Sub-Zero, Viking
<b>Home</b>	Martha Stewart, Williams-Sonoma, Crate and Barrel, The Home Depot, The Great Indoors
<b>Food</b>	Gourmet frozen pizza, ice cream, and ready-to-mix greens
<b>Wine</b>	Robert Mondavi, Kendall Jackson
<b>Lingerie</b>	Victoria's Secret
<b>Automobiles</b>	Lexus, Mercedes-Benz, BMW, Porsche
<b>Pet food</b>	Eagle Pack, Bil-Jac, Diamond
<b>Spas</b>	A \$5 billion industry, growing 25% annually
<b>Toys</b>	American Girl
<b>Sporting goods</b>	Callaway (golf), Nike (basketball shoes)
<b>Beverages</b>	SoBe, Danone, enhanced water
<b>Chocolate</b>	Godiva, Ferrero Rocher
<b>Restaurants</b>	Panera Bread, Outback Steakhouse, The Cheesecake Factory
<b>Electronics</b>	Home theater, HDTV, DVDs, Bang & Olufsen

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SOURCE: BCG analysis.

ury showed its staying power. The fault lines between the old and the new luxury became clear. Tiffany was down, but Starbucks sales grew 20 percent, and comparable store sales continued to rise. Panera Bread, an upscale bakery and quick-service restaurant chain, grew more than 50 percent to over \$500 million, with 6 percent growth in comp store sales. Premium chocolate, an affordable luxury in a down market, grew 10 to 15 percent—two to three times the rate of the overall market. And dark chocolate—the richer, more sophisticated choice—grew to 27 percent of the category from just 20 percent a few years ago. Sales of single-serve bottled water increased more than 30 percent and continued to grow with increasing variety and next-generation enhancements. (See Exhibit 2.)

Victoria's Secret had a strong holiday performance, as did Williams-Sonoma. Longing for the emotional comforts of home, consumers bought higher-end appliances at a surprising rate. The fastest-growing market in consumer electronics for three years running is home theater, where entry-level systems start at \$2,000 and the high end begins at \$100,000.

The differences between the old and the new luxury become even clearer when you look closely at both the consumers and the providers. The buyers of new luxury are not slaves to brands. They are fiercely loyal *when they choose to be*, but they are also discriminating and know their needs. As brand apostles, they are a marketer's dream. They care about the brand's history, romance its "heritage," and urge their friends to try it, just once. The buyers of new luxury form intellectual, emotional, and even spiritual attachments to products and brands.

To afford their new-luxury preferences, consumers are economizing across a wide swath of their purchases, using quality and value as their guides. More

than ever, they are simultaneously trading up and trading down. A sophisticated shopper will recognize a bargain in a well-made knit top on promotion at Target for only \$10 and then spend \$500 on a Gucci handbag. She has the cash and will pay the price.

What the middle-market consumer will not do is fall for mediocrity. She wants quality at all price points and—by selectively reaching for better brands—has become more discerning and more demanding.

## Exhibit 2. Enhanced Bottled Waters Are Entering the Market

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### **Gatorade Propel Fitness Water**

“Vitamin  
charged”



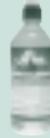
### **Aquéss**

“Delivers 20%  
of daily fiber  
requirements  
as recom-  
mended by  
AHA”



### **Aqua Clara**

“800% more  
pure oxygen  
than ordinary  
water”



### **Peace Mountain Heart Smart Magnesium Mineral Water**

“Give your  
heart a  
healthy start”



### **Glacéau Water**

“Fluid  
embodiment  
of physical  
and spiritual  
well-being”



### **Penta- Hydrate Oxygenated Water**

“The next  
generation  
of water”



### **Hansen's E<sub>2</sub>O Energy Water**

“Infused with  
energy-  
boosting  
ingredients”



### **Looney Tunes Fortified Spring Water (for kids)**

“With fluoride  
and calcium”

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SOURCES: Company Web sites; bevnet.com.

From the supply side, the sellers of new luxury are genuine innovators and entrepreneurs who bring vision and imagination to products and services that have become either expensive and stale or cheap and undifferentiated. These innovators tend to be industry outsiders who take advantage of their freedom from category dogma to imagine a brand that offers more emotional resonance, higher quality, a superior experience, and better economics. They are expert, authentic, and authoritative in every detail. Their product-launch model is different, and they seek out and find visible apostles. They use the resulting mystique to drive loyalty and repurchase. They are masters at segmentation, particularly along emotional dimensions. Unfortunately, the vast majority of current category participants are turning a deaf ear to the new-luxury trend, and by the time they notice it, it may be too late.

## **Because They're Worth It**

Consider pet food. Dogs and cats throughout North America and Europe are enjoying designer dinners specially formulated for their age, breed, lifestyle, and particular dietary needs. The food is attractively packaged, smells good (even to humans), and tastes delicious (or so the animals' hearty consumption suggests). The pet owners who buy premium food do so because it doesn't cost *that* much more, because they believe it's better for their pets, and because they treat their pets like family members.

In recent years, the overall pet-food market in the United States has been growing at approximately 2 percent, with thin—6 to 9 percent—operating margins that are typical in commodity pricing. Stalemate strategies have prevailed, and several of the larger players have merged. But the prognosis looks much

better for the companies that have discovered the affordable luxury market, such as Diamond Pet Foods, Eagle Pack, and Bil-Jac Foods. Those companies are growing at 10 percent per year, with operating margins two to three times the industry average. Today the premium segment represents about 20 percent of category sales but half of profits.

The idea of lavishing so much attention on pets may seem like typical yuppie excess, but the new luxury isn't a branding gimmick. The gourmet-pet-food companies have significantly revamped the product and its delivery, while tapping into their customers' emotional needs. They've built new plants, sourced better raw materials, developed ways to tailor products for special needs, and sought more credible and knowledgeable distribution channels, such as veterinarians and specialty pet stores. It's not advertising hype—the quality is real.

## **What's Driving the New Luxury?**

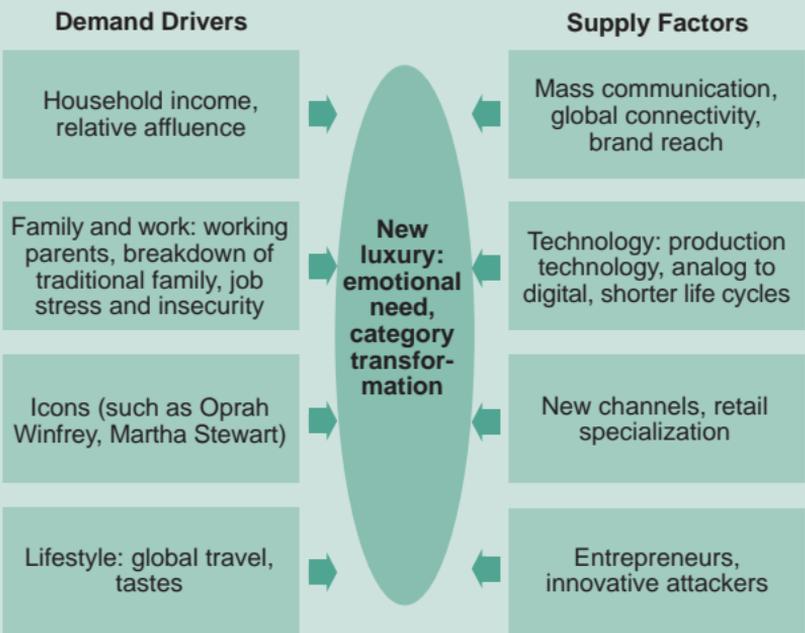
The forces propelling the democratization of luxury are various and strong, on both the supply and the demand sides. (See Exhibit 3.) Travel has created more sophisticated global tastes; technology has made possible higher quality at lower costs (78 percent of new cars have cruise control); and real income has increased considerably. Some 25 million U.S. households now earn more than \$75,000 a year, and they control roughly 77 percent of the country's discretionary spending. Sixty percent of all women work outside the home, contributing almost one-third of household income; and both parents in more than half of two-parent families work.

Today's families have more disposable income, but they lack discretionary time. They feel stressed, inse-

cure, and anxious. The typical U.S. family is working harder now than ever before—seven more hours per week per household than ten years ago. Consumers seek comforts and small pleasures that can provide an emotional salve in their hectic lives.

Working women, in particular, have to deal with the pressures of a career while maintaining the same domestic standards that their nonworking mothers did. Living well isn't only about revenge; it's also about taking care of yourself and finding some measure of emotional fulfillment. Martha Stewart and Oprah Winfrey have become enormously successful as product branders *and* role models by speaking to the emotional desires underpinning the new luxury, such as living well and in good taste, feeling inspired and optimistic, and finding happiness.

### Exhibit 3. Powerful Forces Drive the Democratization of Luxury



SOURCE: BCG analysis.

Oprah has created a movement for a generation of women. She has given women around the world permission to spend and explore, and she has introduced a new vocabulary that insiders cherish. She has defined an emotional space in which self-respect, self-indulgence, and aspiration are validated. The message she spreads is that self-love isn't narcissism: you are as beautiful as you feel, and you need to invest in yourself. With Oprah's permission, consumers can spend more for quality, raise the level of their taste, and splurge on special items.

## A New Set of Rules for the New Luxury

The new luxury has shattered conventional beliefs in nearly all aspects of marketing and branding, including price ceilings, price ranges, brand extendibility, consumer sophistication, market stability, and the time it takes luxury to cascade to the middle market. Here are seven new rules for transforming your category or brand:

**1. Don't underestimate the consumer.** Consumers will trade up to higher levels of quality, taste, and aspiration if doing so brings them emotional and rational benefits. You have to design knowing that consumers know more than you think they do. They will reward honesty, authenticity, and integrity at the core. Robert Mondavi and Kendall Jackson discovered this rule years ago in the wine category when they challenged the long-held assumption that the U.S. palate was unsophisticated and undiscerning. The wine revolution in California, Australia, and elsewhere is still unfolding, but Americans' consumption of wine is very different today from what it was five years ago. From 1995 to 2000, wine sales grew 9 percent per year, compared with virtually flat sales for the prior decade. Consumers also traded up: prices rose three

times the historical average as the mix shifted from blush and jug wines to better varietals and table wines. The trend continued in 2001: jug wine sales declined 4 percent; the under \$7 segment fell 2 percent; the \$7-to-\$10 segment rose 6 percent; and the over \$10 segment grew more than 15 percent.

## **2. Strive to move off the demand curve, not along it.**

The old rule that price and volume are inversely related does not usually hold when a category is transformed by the new luxury. Between exclusive super-premium and traditional mass market lies a rich opportunity to be tapped. With a bold vision, you can price up, spend back, and reap disproportionate profits. Starbucks did it by bringing the romance of the Italian coffee experience to mainstream USA. Victoria's Secret did it by bringing better products, a superior store experience, and great marketing to the U.S. market. Bath & Body Works created a whole new segment of daily luxuries in personal care. The "masstige" segment (premium products with mass appeal and volume) is 20 to 40 percent of many personal-care categories and growing at twice the industry average.

Sub-Zero shattered the conventional wisdom that there was no substantial household-appliance market above the \$1,000 price point. Now General Electric, Maytag, and Whirlpool are struggling to meet demand for their premium lines, while Sub-Zero, with its acquisition of Wolf, is intent on doing it again in cooktops.

## **3. Create a technical-functional-emotional benefits ladder.**

Moving off the demand curve requires a breakthrough set of interrelated benefits that are both rational and emotional. To find a powerful emotional positioning, new-luxury innovators must under-

stand the consumer's behavior, psychological map, "secret needs," and unspoken (sometimes latent) desires. They must also offer distinctive functional advantages that are specifically tied to the targeted emotions, as well as a technical platform that lends credibility and authenticity to the functional claims. Authority and expertise are critical.

If a luxury strategy is well executed, consumers will quickly "ladder" from technical to functional to emotional benefits, responding so powerfully that they will break through traditional price barriers with higher levels of demand. Pet lovers buy gourmet pet food because it is technically superior (it has added nutrients and organic ingredients), functionally reliable (experts attest to its health values), and emotionally satisfying (they are taking care of a "family member"). One word of caution: most traditional market research will miss the emotional underpinnings of new-luxury success, and conventional product testing will just as often undermine the linkages between the emotional, functional, and technical benefit layers. To generate insight, innovative players typically spend more time in the market and conduct one-on-one interviews with their core customers—in their homes, at retail sites, in their domains.

**4. Escalate innovation, elevate quality, and deliver a flawless experience.** The middle market is rich in opportunity, but it is also unstable. Consumers trade down as well as up. Technical and functional advantages are increasingly short-lived. The quality bar is rising at all price points. Luxury benefits are quickly cascading down-market. Nearly 80 percent of all cars have standard features that were exclusively luxury features only a few years ago. A well-established brand can't maintain an emotional position for long if the technical and functional benefits become undifferen-

tiated. Winners in new-luxury markets aggressively up the ante on innovation and quality, and render their own products obsolete before a new competitor does it for them. What's more, their view of quality extends well beyond the product to all customer touch points: marketing, selling, service, visual merchandising, and the retail environment. They fund and treasure meaningful connections with their brand apostles and transform the experience, not just the product.

**5. Stretch the brand over a broader price range with increasingly precise segmentation.** The new luxury offers new ways to think about pricing and subsegmentation. Whereas a traditional competitor's highest price may be three to four times its lowest, new-luxury players often have a fivefold-to-tenfold difference between their highest and lowest price points. They take the brand up-market for aspirational appeal and extend it down-market to make it more accessible and competitive. Defending and building your market position require stretching outward from the core.

Mercedes-Benz and BMW, in an effort to combat Lexus, not only revamped their product lines; they also reconfigured their pricing and subsegmentation strategies. In 1980, 70 percent of Mercedes' sales came from its midprice product line, 21 percent from new entry-price points, and 9 percent from the high end. Today the midprice cars represent 45 percent of sales, with 28 percent at the low end, 21 percent at the high end, and 6 percent in a new superpremium segment. BMW followed a similar pattern. Both brands have become simultaneously more accessible and aspirational, with a top price that approaches ten times the lowest. In last year's down market, BMW's unit sales grew 13 percent and average unit price actually rose slightly. The Martha Stewart brand, which stands for good taste and the best possible quality for the money, also has a tenfold price range

that extends from Kmart to Martha by Mail. Mondavi does the same thing in the wine category, ranging from Woodbridge to Private Reserve and Opus One.

**6. Create and own brand apostles.** Heavy users drive volume and spread the word. A small percentage of category consumers contribute the dominant share of value. In categories with frequent repeat purchases, the top 10 percent of customers typically generate up to half of category sales and profits. That concentration allows for a different kind of launch model, entailing carefully managed initial sales, frequent feedback from first purchasers, unconventional marketing, and word-of-mouth recommendations. Red Bull, a premium-priced “energy” drink, has built a \$100 million business without having to advertise by focusing on the social environments of its core customers: health clubs, bars, and hip hangouts. An intense focus on the core customer will also yield next-generation ideas and early signs of a shifting market.

**7. Attack your category as if you were an outsider.**

Since outsiders have generated the majority of disruptive innovations, incumbents must find a way to break the pattern and create an outside-in approach to the evolution of their categories. Rules of thumb and everyday customer compromises are treasure maps for finding opportunity. Innovators must also look beyond their own categories for the trends and patterns that will generate the next big breakthrough. Sources of inspiration might include upmarket products or services, innovations from Europe or Asia, analogues from other categories, and advice from experts and professionals. When the makers of Freschetta Pizza, for example, sought to overtake Kraft’s DiGiorno in the premium-frozen-pizza segment, they assembled a panel of five gourmet chefs from the best restaurants in the United States. The chefs, in turn,

worked closely with some of the best cooking schools in Italy to develop a superior sauce and crust.

## **Leadership: A Call to Action**

The providers of new luxury target and fill real needs that are emotional—even spiritual—as well as economic and practical. Consumers yearn to feel special. They need testaments to their self-worth and antidotes to their stresses. The movement is unstoppable, considering our times; and it is both an evolution with definable roots and drivers, and a revolution that is provoking rapid change in unexpected areas. For established competitors, it can be an opportunity or a threat. Meeting that challenge will require a new frame of reference and a different kind of leadership: more imagination and less dogma, more courage and less convention, more creativity and less incrementalism. The democratization of luxury gives imaginative leaders a new way to think about growth, profitability, and the art of fulfilling dreams.

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WILLIAMS-SONOMA



PRADA



GUCCI



VICTORIA'S SECRET



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