Opportunities for Action in Consumer Markets

Trading Up to New Luxury

The Boston Consulting Group
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America’s middle-market consumers are trading up. They are willing, even eager, to pay a premium price for remarkable kinds of goods that we call New Luxury—products and services that possess higher levels of quality, taste, and aspiration than other goods in the category but are not so expensive as to be out of reach. So many middle-market consumers want to trade up—and so many can now afford to—that New Luxury goods have flouted the conventional wisdom that says, The higher the price, the lower the volume. They sell at much higher prices than conventional goods and in much higher volumes than traditional luxury goods—and, as a result, have soared into previously uncharted territory, high above the familiar price-volume demand curve.

In category after category of consumer goods and services, New Luxury winners have emerged, traditional leaders have been dethroned, and the entire category has been transformed. The phenomenon forces us to think in new ways about the relationship between consumer needs and consumer goods, and it offers a huge opportunity for business leaders to pursue their own aspirations and realize growth and profit as well. America is trading up, and it’s good for both business and society.

The trading-up phenomenon is happening in scores of categories of goods and services, at prices ranging from just a few dollars to tens of thousands. It involves consumers who earn $50,000 a year and those who
earn $200,000. Single moms do it, retired couples do it; working singles, families with kids, and even their pets do it. We have interviewed hundreds of middle-market consumers, observed hundreds more in their homes and workplaces, and conducted a survey of more than 2,300 people with household incomes of $50,000 or more. Ninety-six percent of them say they will pay a premium for at least one type of product. With 47 million households in the United States with incomes of $50,000 or more and an average household size of 2.6 people, that’s 122 million Americans with the means and the desire to trade up. (See Exhibit 1.)

Who are these consumers and what are they buying? All kinds of people trade up every day to many types of goods for many reasons—some of them unexpected and counterintuitive. Perhaps the most startling “traders-up” we talked with were a group of consumers who were ecstatic about a product category that most people would like to forget—a washer-dryer combination from Whirlpool called Duet. The pair sells for more than $2,000, compared with about $600 for a

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**Exhibit 1. Consumers Will Pay Premium Prices for Better Products**

Ninety-six percent of consumers say they will pay a premium to buy at least one type of product.

Almost half will pay “as much as they can” for certain items.

Seventy-six percent say some products are just too important to scrimp on.

Fifty-one percent say that even when the economy is bad, they will spend on “affordable luxuries.”

Fifty-eight percent concentrate spending on a few categories that matter the most to them.

SOURCE: BCG Harris Interactive survey of adults with more than $50,000 in household income, November 2002.
conventional washer-dryer combination. Believe it or not, consumers made the following comments about these European-styled, front-loading machines: “I love them.” “They are part of my family.” “They are like our little mechanical buddies—they have personality.”

We are not making this up, and these folks are not paid spokespeople or company employees. They are both women and men, with a range of demographic characteristics who told us again and again that Duet makes them feel happy, like a better person, less stressed, prouder of their children, loved and appreciated, accomplished. In our 50 combined years of listening to consumers, we have never heard more heartfelt expressions of emotion about a product that even industry insiders think of as mundane and unworthy of attention. Five years ago, Whirlpool’s brand managers, in their wildest dreams, had not imagined there could be that much unit volume for a washer-dryer at that price. Even today they are astonished by their own success—and are struggling to build enough machines to keep up with demand.

Another trader-up who stands out is Jake, a 34-year-old construction worker earning about $50,000 a year whose great passion is golf. It took Jake a year to save enough money to buy a complete set of Callaway golf clubs—$3,000 worth of premium titanium-faced drivers, putters, and wedges—although he could have bought a decent set from a conventional producer for under $1,000. During the eight-month golf season in Chicago, Jake works the 6 a.m. shift so he can be on the course by 2 p.m. He plays 18 holes nearly every weekday after work and—again, believe it or not—twice on Saturday and twice more on Sunday. He is a three-index golfer, which means he is in the top 1 percent of all recreational golfers in terms of skill. We played a round of golf with him at a public course, during which he described in detail the tech-
nical differences and performance benefits of his Great Big Bertha clubs.

“But the real reason I bought them,” Jake told us at last, “is that they make me feel rich. You can run the biggest company in the world and be one of the richest guys in the world, but you can’t buy any clubs better than these.” Then, looking at us with a hint of a smile, he said, “When I kick your butt on the course, I feel good. I feel equal. I may make a lot less money than you do, but I think I have a better life.” After the round (during which he did, in fact, kick our butts), Jake carefully placed his clubs in his pickup truck and said, “Thank you, Mr. Callaway, for another fine day.”

In 1989, Callaway Golf was not a top 10 golf-equipment supplier. Within three years of the introduction of the Big Bertha driver in 1990, the company soared to number one in the world.

Trading up spans so many categories and appeals to such a broad range of consumers that it has come to represent a major and growing segment of the economy. In 23 categories of consumer products and services worth $1.8 trillion in annual sales, New Luxury already accounts for 19 percent of the total, or around $350 billion per year—and it’s growing at a rate of 10 to 15 percent annually. The demand is highly elastic because...
it can be created in categories that have never had a premium offering before and because even a category that has been transformed by a New Luxury product can be traded up again.

The Characteristics of New Luxury

From our analysis of the most successful New Luxury goods in more than 30 categories, we have identified three major types.

*Accessible superpremium products* are priced at or near the top of their category, and at a considerable premium over conventional offerings. They are still affordable for the middle-market consumer, however, because they are relatively low-ticket items. For example, Belvedere vodka sells for about $28 a bottle—a 75 percent premium over Absolut at $16. Nutro pet food sells at 71 cents per pound—a 58 percent premium over Alpo at 45 cents per pound. Almost anyone can afford a bottle of Belvedere or a bag of Nutro if those categories are emotionally important to him or her.

*Old Luxury brand extensions* are lower-priced versions of products created by companies whose brands have traditionally been affordable only to the rich—households earning $200,000 or more. Mercedes-Benz, for example, has dramatically changed its product mix in the past ten years, with continual reductions in the price of the entry-level C-class sport coupe (now about $26,000) and a steady increase in revenue from the model. Mercedes-Benz has also worked to keep the brand aspirational by extending it upmarket as well. Its Maybach sells for over $300,000—more than ten times the price of the C-class sport coupe. Such Old Luxury brands have mastered a neat trick: becoming simultaneously more accessible and more aspirational.
Masstige goods—a neologism for mass prestige—are neither at the top of their category in price nor related to other iterations of the brand. They occupy a sweet spot in the market “between mass and class,” commanding a premium over conventional products but priced well below superpremium or Old Luxury goods. Bath & Body Works body lotion, for example, sells at $9 for an 8-ounce bottle ($1.13 per ounce)—a premium of 275 percent over Vaseline Intensive Care, which sells at $3.29 for 11 ounces, or $0.30 per ounce. But it is far from the highest-priced product in the category: Kiehl’s Creme de Corps, one of many superpremium skin creams, retails at $24 for an 8-ounce bottle—a 167 percent premium over the Bath & Body Works product. And there are many other brands that sell for far more.

Despite the wide price range of New Luxury goods and the variety of categories in which they appear, they have characteristics in common that are different from those of superpremium or Old Luxury goods and also from those of conventional, midprice, middle-market products. Most important, New Luxury goods are always based on emotions, and consumers have a much stronger emotional engagement with them than with other goods. Even relatively low-ticket items, such as premium vodkas,

Are you in love with your car or do you just live with it?
have a well-defined emotional appeal for their consumers. The engagement tends to get more intense and long lasting with big-ticket items, such as home appliances and automobiles. BMW drivers, for example, are particularly engaged with their cars. Michael Ganal, a BMW board member, told us that BMW owners wash their cars more frequently than owners of other cars do. They park them on the street and then turn back to gaze lovingly at them as they walk away. They say that the first sight of their BMW in the airport parking lot is like a warm welcome home. By contrast, very expensive Old Luxury goods—such as Chanel handbags and Rolls-Royce cars—are based primarily on status, class, and exclusivity rather than on genuine, personal emotional engagement. And the appeal of traditional middle-market goods is based more on price, functionality, and convenience than on emotional connection. It’s a rare Taurus driver who can be found gazing fondly at his or her parked car.

Emotional engagement is essential, but not sufficient, to qualify a product as New Luxury; it must connect with the consumer on all three levels of a ladder of benefits. First, it must have technical differences in design, technology, or both. Subsumed within this technical level is an assumption of quality—that the product will be free from defects and perform as promised. Second, those technical differences must contribute to superior functional performance. It’s not enough to incorporate “improvements” that don’t actually improve anything but are intended only to make the product look different or appear to be changed. (U.S. automakers played that game for years.) Finally, the technical and functional benefits must combine—along with other factors, such as brand values and company ethos—to engage the consumer emotionally. Most consumers make one dominant emotional connection with a product, but there are usually others involved as well.
When a New Luxury brand solidly delivers the ladder of benefits, it can catch fire. It will take hold in the minds of consumers, quickly change the rules of its category, grow to market dominance—as Starbucks, Kendall-Jackson, and Victoria’s Secret have done—and force a redrawing of the demand curve. As that happens, the category tends to polarize. Consumers shop more selectively. They trade up to the premium New Luxury product if the category is important to them. If it isn’t, they trade down to the low-cost or private-label brand, or even go without. They scrimp and save across a broad swath of spending in order to afford their New Luxury purchases—polarizing the household budget.

Almost every American engages in this practice of rocketing—spending a disproportionate amount of his income in a category that holds great meaning. (See Exhibit 2.) The combination of trading up and trading down leads to a disharmony of consumption—meaning that a consumer’s buying habits do not always conform to her income level. She may shop at Costco but drive a Mercedes, for example, or buy private-label dishwashing liquid but drink premium Samuel Adams beer.

As consumers buy more selectively, trading up and trading down, they increasingly ignore the conventional, midprice product that fails to deliver the ladder of benefits. Why bother with a product that offers neither a price advantage nor a functional or emotional benefit? Companies that offer such products are in grave danger of death in the middle: they will be unable to match the price of low-cost products or the emotional engagement of New Luxury goods. They will lose sales, profitability, market share, and consumer interest. To survive, they must lower prices, revitalize and reposition their products, or exit the market.
The Forces Behind New Luxury

What has caused the rise of New Luxury and what forces are fueling its growth? We believe that the trading-up phenomenon has come about as the result of a confluence of social forces and business factors. Not since the spread of suburbia and the rise of “conven-
ience” goods in the post–World War II era have we seen this kind of alignment of consumer wants and needs with the capabilities and drives of industry. At that time, consumers’ desire for manufactured goods soared in an arc parallel to that of industry’s ability to produce them. After the emotional and psychic hardships of the war, Americans wanted cars, refrigerators, and household goods in unprecedented quantities. And thanks to newfound capabilities developed and sharpened in the hurry-up production of war materiel—including aircraft, weapons, uniforms, and packaged goods—U.S. industry was ready and eager to meet the demand. Americans wanted to put the pain of war behind them and stretch their new muscles of world dominance.

Similarly, today the U.S. consumer is in a state of heightened emotionalism. And similarly, U.S. businesses have at their command a new set of skills and capabilities. Furthermore, like that earlier consumer-goods boom, New Luxury is no fad: it is driven by fundamental, long-term forces on both the demand and the supply sides, forces that will keep it thriving for years to come. (See Exhibit 3.)

**Demand-Side Forces.** On the demand side, trading up is being driven by a combination of demographic and cultural shifts that have been building for decades. Most important, U.S. households simply have more discretionary wealth available to spend on premium goods than ever before. Real household income has risen for all Americans over the past 30 years, and it has risen fastest for the highest earners. Income for the top quintile—households earning more than $82,000—has risen nearly 70 percent in real terms. (See Exhibit 4.) As a result, those 21 million affluent households control nearly 60 percent of the nation’s discretionary purchasing power. Homeownership has also contributed to consumers’ increased wealth.
Exhibit 3. Consumer Needs and Business Capability Are Aligned As Never Before

Demand Drivers
- Higher real incomes
- Rising home values
- Cash windfall courtesy of discount retailers
- Role of women and changing family structure
- Higher levels of taste, education, and experience
- Emotional awareness and "permission" to spend

Supply Drivers
- Entrepreneurs on personal journeys
- Changes in the dynamics of retailing
- Access to flexible supply-chain networks and global resources

New Luxury
- Emotional need
- Category transformation

Exhibit 4. The Highest-Income Households Are Growing the Fastest

<table>
<thead>
<tr>
<th>U.S. households by income</th>
<th>Mean household income ($thousands)</th>
<th>Increase in mean household income, 1970–2000 (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fifth quintile</td>
<td>83.8</td>
<td>141.6</td>
</tr>
<tr>
<td>Fourth quintile</td>
<td>47.3</td>
<td>65.7</td>
</tr>
<tr>
<td>Third quintile</td>
<td>33.6</td>
<td>42.4</td>
</tr>
<tr>
<td>Second quintile</td>
<td>20.8</td>
<td>25.3</td>
</tr>
<tr>
<td>First quintile</td>
<td>7.8</td>
<td></td>
</tr>
</tbody>
</table>

Source: U.S. Census Bureau's current population survey and annual demographic supplements.
Note: All figures are in 2000 dollars.
Homeowners, on average, have $50,000 worth of equity in their homes, and the entire pool of U.S. home equity is $7 trillion. Another, less obvious contributor to increased wealth is the savings that have been passed on to consumers by large discount retailers. Over the years, mass retailers have reduced costs and compressed margins so much that they have reduced the cost of living for middle-market consumers. We estimate that in 2001 approximately $100 billion was freed up in this way and became available for New Luxury spending.

Just as important as the increased wealth of Americans is the newly dominant role played by women, both as consumers and as influencers of consumption. The percentage of women in the work force has risen steadily and dramatically over the past four decades, and the percentage of married couples with a wife in the paid labor force has nearly doubled. Not only are more women working, they are earning higher salaries than ever before; nearly one-quarter of married women make more money than their husbands do. Women feel that they have the right to spend on themselves. Over and over again, they told us, “I earned it. I can spend it however I want, including on myself.”

Partly as a result of these demographic shifts, the traditional American family is getting harder to find: only 24 percent of U.S. households consist of a married couple with kids living at home. Both men and women are getting married much later in life, and they are having fewer children. The result is that there are more singles with more money to spend on themselves. And because families are smaller and have higher incomes, there is more per capita wealth. Although people are getting married later, they are no more successful at making their marriages work. Half of all first marriages end in divorce; one-third of
all marriages fail in the first ten years. When couples break up, their consumption patterns change dramatically: the new singles spend more of their money on themselves, both to rebuild their “personal brand” (how they present themselves to the world) and as a salve for their emotional distress. Although women tend to have less wealth after a divorce than when they were married, divorced women are pronounced rocketers. They tell us they spend disproportionate amounts of their money on a wide range of goods that they believe will make them more attractive and help ease the pain of the breakup.

The profile of the U.S. consumer is also changing. The middle-market consumer of today is better educated, more sophisticated, better traveled, more adventurous, and more discerning than ever before. Today more than half of all Americans over the age of 25 have some college education. Educated consumers are eager to know about the products they use and the context of their categories. And their travels have exposed them to the styles and tastes of other countries, particularly those of Europe. (In 1970, 3 million Americans visited Europe; 11 million visited in 2000.) Well-traveled consumers seek out the tastes and styles they discovered in foreign places in goods they can buy and enjoy at home. (See Exhibit 5.)

Finally, middle-market consumers are more aware of their emotional states and are more willing to acknowledge their needs, talk about them, and try to respond to them. We all receive countless messages every day—especially from media influencers and celebrity endorsers—urging us to reach for our dreams, fulfill our emotional needs, go for the gusto, self-actualize, take care of ourselves, and feel good about who we are. What’s more, these messages are often intertwined with, or linked to, New Luxury goods. Oprah Winfrey endorses products, Martha
Exhibit 5. U.S. Travel to Europe Has Greatly Increased

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of Travelers (Millions)</th>
</tr>
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<tbody>
<tr>
<td>1955</td>
<td>Boeing introduces the 707 (the first intercontinental jet) in 1957</td>
</tr>
<tr>
<td>1960</td>
<td></td>
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<tr>
<td>1965</td>
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<td>1970</td>
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<td>1972</td>
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<td>1974</td>
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<tr>
<td>1976</td>
<td></td>
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<tr>
<td>1978</td>
<td>The Airline Deregulation Act passes in 1978</td>
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<tr>
<td>1980</td>
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<tr>
<td>1982</td>
<td></td>
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<td>1984</td>
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<td>1996</td>
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<tr>
<td>1998</td>
<td></td>
</tr>
<tr>
<td>2000</td>
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</tbody>
</table>

Source: Statistical Abstract of the United States, selected editions.
Stewart sells them, Sarah Jessica Parker and her friends on *Sex and the City* display them. (See Exhibit 6.)

These factors have transformed the profile of the “average” middle-market U.S. consumer from an unassuming and unsophisticated person of modest means and limited influence into a sophisticated and discerning consumer with high aspirations and substantial buying power and clout.

**Supply-Side Forces.** Forces on the supply side have been just as important in producing the New Luxury business endeavor. Perhaps most important is the increased acceptance and role of the “outsider”—the

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**Exhibit 6. New Luxury Serves a Powerful Set of Emotional Needs**

<table>
<thead>
<tr>
<th>Taking Care of Me</th>
<th></th>
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</thead>
<tbody>
<tr>
<td>Well-being: physical and spiritual health</td>
<td></td>
</tr>
<tr>
<td>Beauty and youthfulness</td>
<td></td>
</tr>
<tr>
<td>Finding leisure time</td>
<td></td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Connecting</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Attractiveness, romance, and “hooking up”</td>
<td></td>
</tr>
<tr>
<td>Affiliation</td>
<td></td>
</tr>
<tr>
<td>Membership: being “part of the club”</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Individual Style</th>
<th></th>
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</thead>
<tbody>
<tr>
<td>Status and achievement</td>
<td></td>
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<tr>
<td>Security and comfort</td>
<td></td>
</tr>
<tr>
<td>Sophistication and success</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Questing</th>
<th></th>
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</thead>
<tbody>
<tr>
<td>Taste and discernment</td>
<td></td>
</tr>
<tr>
<td>Adventure</td>
<td></td>
</tr>
<tr>
<td>Learning</td>
<td></td>
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</tbody>
</table>

*Source: BCG analysis.*
entrepreneur or innovator who gathers ideas and inspiration from sources outside the category, rejects the conventional wisdom of the leaders, and works outside the system. (At least initially: often the outsider’s way becomes the established system.)

Like the consumers of their goods, these innovators are usually more knowledgeable, sophisticated, and emotionally driven—and less willing to settle for creating conventional goods—than established managers in the category. Pleasant T. Rowland, for example, created the American Girl doll because she wanted to buy a gift for her niece but was completely dissatisfied with Cabbage Patch Kids and the other dolls she found on the market. She built her company into a $300 million business, selling dolls with historical characters and finely detailed and accurate accessories at $84 each.

Changes in retailing have also contributed to the trading-up phenomenon by increasing the availability of New Luxury goods in retail outlets across the United States. The proliferation of malls throughout the country has made it possible for premium specialty retailers, such as Williams-Sonoma and Victoria’s Secret, to expand quickly. Mass merchandisers have also played an important role in the spread of New Luxury goods, stocking more and more premium items on their shelves. Costco, for example, now stocks a larger selection and sells a larger volume of premium wine than any other retailer. Costco stores sell more first-growth wines from the Bordeaux region of France than any other retailer, including wine specialty chains. As retailing has polarized, traditional department stores have found themselves stuck in the middle. They offer similar assortments of goods, display them in similar ways, and provide little emotional engagement or uplift for the shopper. As a result, traditional department stores are in a state of decline.
New Luxury creators have also benefited from the globalization of business and trade. The easing of international trade barriers, the improving capabilities of global providers of supply chain services, and the reduced costs of international shipping have enabled companies of almost every size to take advantage of foreign labor markets and to put together and manage complex global networks for sourcing, manufacturing, assembling, and distributing their goods.

These supply-side factors have made it easier for New Luxury companies to attract investment for the creation of their goods, develop their products faster and produce them at lower cost, and increase production volume quickly when consumer demand increases.

**Seeing the Pattern**

Trading up poses an imminent threat or presents an immediate opportunity, depending on one’s circumstances and point of view. The threat is felt mostly (or should be) by companies offering conventional, mid-price products to the middle market: when a New Luxury competitor enters the category, polarization can happen so fast that it becomes difficult to escape death in the middle. The opportunity is most potent for an entrepreneur or a business with the vision and resources to enter a category that has stagnated and can be traded up. New Luxury creators can move very rapidly from idea to prototype, sometimes in as little as a year. They can create initial product runs in low volumes, with minimal capital investment. They can often build out their business within five years. When they’re ready to sell, there are eager buyers.

We have learned that New Luxury goods cannot be created (by either entrepreneurs or established companies) with the methods traditionally used to devel-
op products and bring them to market. Across categories and in very different kinds of organizations, New Luxury leaders follow eight practices:

1. **They never underestimate their customers.** They believe the consumer has the desire, interest, intelligence, and capability to trade up—even when the entrepreneur has no data to prove it or business model to follow.

2. **They shatter the price-volume demand curve.** They don’t settle for incremental improvements or price increases. They prefer the major leap and the big premium. They go for higher prices and higher volume.

3. **They create a ladder of genuine benefits.** They don’t try to fool their customers with meaningless innovations, nor do they try to get by on brand image alone. They make technical improvements that produce functional benefits that result in emotional engagement for the consumer. They don’t try to pretend that better cosmetics are true innovations.

4. **They escalate innovation, elevate quality, and deliver a flawless experience.** The market for New Luxury is rich in opportunity, but it is also very unstable. Technical and functional advantages are increasingly short-lived as new competitors enter the market, and the cascade of innovations from high-end products to lower-priced ones is accelerating. What is luxurious and different today becomes the standard brand of tomorrow. Nearly 80 percent of all cars have standard features, such as antilock brakes and power locks, that were exclusively luxury features a few years ago. A well-established brand can’t maintain an emotional position for long if the technical and functional benefits become undifferentiated.
5. *They extend the price range and positioning of the brand.* Many New Luxury brands extend the brand up-market to create aspirational appeal and down-market to make it more accessible and competitive, and to build demand. 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 are careful, however, to create, define, and maintain a distinct character and meaning for each product at every level, as well as to articulate the brand essence that all the products share.

6. *They customize their value chains to deliver on the benefit ladder.* They put the emphasis on control of the value chain rather than on ownership of it, and they become masters at orchestrating the value chain. Jim Koch, founder of The Boston Beer Company, specified the process for making Samuel Adams Boston Lager (which combined aspects of nineteenth-century brewing with twentieth-century quality-control methods), selected the ingredients, and managed distribution; but he did not choose to grow his own hops or build extensive production facilities.

7. *They use influence marketing and seed their success through brand apostles.* In New Luxury goods, a small percentage of category consumers contribute the dominant share of value. In categories with frequent repeat purchases, such as lingerie and spirits, the top 10 percent of customers typically generate up to half of the sales and profits. New Luxury leaders do not rely solely on traditional consumer-research methods, such as polling and focus groups, to understand who those core customers are; they work harder to define their core audience and spend more time interacting with customers,
often one-on-one. Reaching those customers requires a different kind of launch, which involves carefully managed initial sales to specific groups in specific venues, frequent feedback from early purchasers, and word-of-mouth recommendations.

8. They continually attack the category like an outsider. They think like outsiders, act like mavericks, talk like iconoclasts, and strive never to think of themselves as insiders, even after they have become the leader in their category.

New Luxury is a strategy and, as such, must be developed and executed by CEOs and divisional leaders of large companies, as well as by entrepreneurs and innovators in smaller companies. New Luxury is product centered, and so affects product developers as well as supply chain managers. It also requires a keen understanding of consumers’ motivations and buying behavior, and so has significance for market researchers and marketers. New Luxury affects, or will soon affect, a wide range of businesspeople in almost every consumer-goods category, including consumables, durables, and services. You can still catch this wave.

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