Profitability and Resilience of Luxury Market to the Financial Crisis during 2007-08

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Abstract. The Financial crisis of 2007-08 has successfully hit the dollar value, developed economies and demand levels of multiple nations. The financers, capitalists and common man together decided to be conservative on spending. The economies kept calculating the means to survive out of it. In the troublesome circumstances of such, the market of luxury was reported to be growing at a fast pace. The ordinary of extraordinary people and the extraordinary of ordinary people is luxury. The study is to check the assertions made for the luxury market. The profitability level of the market is tested of the S&P Global Luxury Index that comprises of the 80companies. The data is collected from Bloomberg database, 2004-13. The data is categorized into two phases –pre (2004-06) and post (2009-13) crisis. The paired T-test is run over the data series of three profitability ratios- ROA, NPR and ROE. The investors' return on equity is not significantly hampered in the post phase in the market as well as the sector wise segregation. The tuff times of crisis have proved to bring diminishing values for net profit ratio in the Hotel, leisure and Beverages, Household and personal care sectors.

Keywords: Financial Crisis, Luxury Market, Profitability, Resilience

1 Introduction

Recession - the so called negative phase of the business cycle. It is not an event, it is an era. It is generally considered a disappointing situation for the entrepreneurs, employees, competitors, investors, banks, insurance and many more. Only a handful of organizations have opportunities in this phase. Economists say that credit base of the economy impelled them to burst the overheated demand. Can the concept of profitability be discussed in such scenarios? Is there any such market which can fetch gains to the investors and the industrialist associated to them? In the ages of collapse and sinking trends seen across the globe, there is one market which has been an attention seekers and could sustain from the shocks- the market of extremes- the luxury market. These organizations' clientele are inelastic to factors in the market. A renowned scholar Sombart in his essay on concept and nature of luxury (1992) explains luxury is such an expenditure that is beyond necessity. The ordinary of extraordinary people and the extraordinary of ordinary people is luxury (Kapferer and Bastien, 2009). The crisis, contagion and the

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consumption are the key issues to study any market in the financial meltdown. The economic sustainability of the firm can be initiated by the profitability of the sector. A "financial ratio" is a quotient of two numbers, where both numbers consist of financial statement items (Beaver, 1966). The study is intended to confer the profitability of the luxury market in the two situations of Pre and Post Crisis 2007-08.

The researchers have interpreted luxury differently. Professor PauravShukla, has aptly considered and defined luxury as a state of mind. The primary issue in the study of luxury is the concept's relationship to necessity. "Luxury is any expenditure that goes beyond the necessary" (Sombart, 1992). Mandeville defined luxury as "everything that is not immediately necessary to make Man subsist" (Mandeville, 1732). Appadurai, lists five characteristics of luxury (Appadurai, 1986), (1) Restriction to elites by law or price (2) Complexity of acquisition – which may or may not reflect real "scarcity" (3) Semiotic virtuosity (4) Codes for "appropriate" consumption demanding specialized knowledge (5) High degree of linkage of their consumption to body, person and personality.

Chevalier and Gutsatz (2012) in "Luxury Retail Management: How the World's Top Brands Provide Quality Product and Service Support" gives important suggestions about Luxury Retail Management and world of luxury retail. Jonas Hoffmann, Ivan Coste-Maniere (2011) in "Luxury Strategy in Action" explains regarding luxury, luxury brand and HNIs.

Ever since the 1980s, the luxury market has shown an upside graph at about ten per cent per annum, an outperforming rate than the world economy, making the luxury industry a relevant economic factor. Estimates of the size of the market for traditional luxury categories including fashion, jewellery and tableware ranges from about 150 billion € to 200 billion € in 2010 (Heine, 2012). Luxury has a broader degree of definition. At the beginning of the twenty-first century, luxury has become a sign-value in a world of signs with which people distinguish themselves from others. This is in contrary to the Veblen view of demonstrative consumption (for Veblen goods demand increases more than proportionately as income rises). These goods are believed to have high income elasticity of demand: as people turn more affluent, they purchase more of the luxury good. Snobbish behaviour is when an individual tends to buy less of the product if other people are buying the same.

2. Literature Review

The review of literature is to highlight the comprehensive idea of the work that has already been done in the related issues. It also gives insight about the methodology for the prospective research. Multiple studies have been done from different aspects of the performance measures, in the several sectors. The following pieces of studies have been reviewed before proceeding and also to locate the research gaps.

Connor (1973) studied the ability of accounting data (e.g., in the form of ratios) to fulfil the needs of the dominant (or largest) investor group. Financial statement data and price-relative data were obtained for the period January, 1950-March, 1966 for 127 firms. The group of 33 ratios initially chosen was reduced to a smaller group of 10 ratios, which was the group of ratios actually used in the analyses. He contributed a regression model of determining the ROR to the investors.

Claessens, Djankov and Colin (2000): studied the sharp decline in the performance of East Asian corporations following the 1997 financial crisis. This article compares the growth and financing patterns of East Asian corporations in the years before the crisis with those in other countries. It finds little microeconomic evidence that corporate growth was weakening but some support for the argument that many firms had a weak financial structure that left them vulnerable to an economic downturn. Based on a sample of more than 850 publicly listed firms in the four crisis countries- Indonesia, Malaysia, the Republic of Korea, and Thailand-and two comparators, Hong Kong (China) and Singapore, it appears that firm-specific weaknesses already in existence before the crisis were important factors in the deteriorating performance of the corporate sector.

Kapferer and Tabatoni (2010): Although modest in terms of sales, luxury does get a high share of investors', financial analysts' attention. The reason this sector receives a share of attention much bigger than its actual weight is because of the prestige attached to its major brands .The most often heard explanation is that luxury would be a financiers' dream and exhibit a very high profitability. The paper analyzed luxury companies' key financial performance indicators over other sectors to assess the validity of the sector attractiveness among the financial community. The findings about the luxury industry can be easily summarized: although one has not found a defining specificity in terms of operational performance except for high gross margin, however a dream factor seems to operate with financial markets; PER and P/S ratios

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testify to it. Luxury groups enjoy clearly superior valuation multiples which could not be justified on the basis of shareholders expectations in terms growth and profitability.

Lopez et al. (2011) studied the performance of several hundred SMEs during the worst stages of the financial crisis during 2008-2009. The authors report of a significant decline in profitability as a result of a sharp decrease in top line revenues. The main negative consequence of worsening profit margins is recorded on gross operating profit and EBITDA. Consequently the authors noted that as a counter measure to the negative impact of falling demand, the companies typically increase asset turnover as a result of decrease of the overall investment in the businesses. Furthermore, Lopez et al. (2011) argue that the fall in profitability is also higher in terms of return on equity as prior to the crisis a large proportion of the sample had levered their balance sheets. Thus despite the gradual reductions in the interest rates going through the crisis the increase in financial costs explains part of the decline in ROE.

Marques et al. (2011) argue that the effects of the downsizing are not bearing fruits as expected as they do not find evidence of improved performance after downsizing by using measures of ROA and profit margins. On the contrary, the authors argue that downsizing is most often used as a reactive tool and as such the companies launching broad downsizing campaigns are probably poorly run in the first place. Their findings suggest that during a steep crisis such as the recent one downsizing does not add to the companies' long-term profitability rates.

Wilson et al. (2012) studied the profitability performance of private equity backed companies during recessionary times. They find significant differences in terms of profitability during crises. The profitability of these companies – both when measured with ROA and profit margins – remained clearly higher than the peer groups' during the studied period. The authors suggest that this is due to a selection bias as the financial investors target usually more solid companies in the first place but also due the owners' ability to increase efficiency and add to the operational performance during their ownerships.

Singh, Jain and Yadav (2013) studied the profitability of the 166 non-financial companies of the BSE 200 index with particular emphasis on a pre- and post-recession analysis for the period 2001-2011 with an attempt to link the profitability with the liquidity of the sample firms. The profitability of sample companies (measured through gross profit and net profit), prima-facie, appears to be stable and attractive (as an investment choice). Though the recession did

witness some fluctuations in the profitability of certain constituent sectors, overall, the sample seems to have emerged unaffected from the impact of the recession, perhaps due to its strong financial fundamentals.

3. Objectives of the Study

The aforesaid literature has been done on the crisis, luxury market and the profitability of the industries and the portfolios. Some piece of work have covered the profitability aspect of industries, many have detailed the impact of the crisis on the feasibility and resilience of the sector to the downturns. But there have hardly been many attempts to study the industry which was known to be the industry of riches to segregate them from the rest. This industry was not just for the economies that were known to be too big to fail. There were reports pointing out to an upward trend in this market where the rationale behaviour of the profitability was falling. The study is intended to analyse if this section could sustain in the tuff times or not. Not many works have yet been accomplished in the area of profitability of pre and post crisis 2007-08. This paper also addresses the corporate resilience of the luxury sector.

Previous researches have reported the performance of luxury segment but all of them could not establish the consensus in the said regard. This study is intended to focus on the profitability of luxury market and how it has been affected with the advent of financial crisis 2007-08. Following are the research objectives:

i. To study the impact of financial crisis 2007-08 on the profitability of the firms in the luxury market.
ii. To analyze sector wise profitability of the luxury firms.
iii. To list the sectors of the luxury market that proved to be resilient to the crisis.
iv. To study the relationship between economic downturn and the potential for the luxury sector.

4. Development of Research Hypothesis

We claim to undertake the study around the following hypothesis:

H_{01}: There is no significant difference in the profitability of the firms in the luxury market pre and post financial crisis 2007-08.

H_{02}: There is no significant difference in the profitability of the firms in the luxury market of Automobiles and Specialty sector pre and post financial crisis 2007-08.

H_{03}: There is no significant difference in the profitability of the firms in the luxury market of Hotel, leisure and Beverages pre and post financial crisis 2007-08.

H_{04}: There is no significant difference in the profitability of the firms in the luxury market of Household and personal care pre and post financial crisis 2007-08.

H_{05}: There is no significant difference in the profitability of the firms in the luxury market of Textiles, Apparel & Luxury Goods pre and post financial crisis 2007-08.

4. Research Methodology

As far as data collection for the study is concerned, it is secondary source. The collected sample consists of the companies in the "S&P global luxury index". The source of the data was Bloomberg database for calendar year 2004-2013. The S&P Global Luxury Index is comprised of the largest publicly traded companies engaged in the production or distribution of luxury goods or the provision of luxury services. By an observation of 2004, it refers to the last day of the calendar year i.e. 31st December 2004. This portfolio is a basket of 80 companies classified as eleven sectors on the basis of Global industrial classification Standards (GICS) codes, i.e. Automobiles (5 members), Beverages (5 members), Diversified Consumer Services (1 member), Hotels, Restaurants & Leisure (25 members), Household Durables (5 members), Internet &Catalog Retail (2 members), Leisure Products (2 members), Multiline Retail (1 member), Personal Care Products (4 members), Specialty Retail (8 members), Textiles, Apparel & Luxury Goods (22members). The total observations for 80 companies, 3 accounting ratios in 10years are 2,400 (80 x 3 x 10).

The grouping of GICS sectors had very few numbers of companies in each group. Then the data is clubbed on the basis of the similar principal business operations and the now the data is classified into four sectors, namely automobiles and specialty (13 members), Hotel, leisure and Beverages (32 members), Household and personal care (13 members) and Textiles, Apparel & Luxury Goods (22 members).

Further, the pre and post crisis financial performance of the luxury sector, the data is divided into two phases - pre crisis phase and post crisis phase. The structural break suggested that the markets confronted the slow down during February 2007 and august 2008. So the pre-crisis phase covered the observations from 2004 to 2006 (three years) and post crisis phase has years between 2009 and 2013 (five years). The paired T-Test is applied on the complete data and also on four different sectors on the arithmetic mean of the two phases to statistically test if the

variables have shown any significant changes overtime. The two tail pair T-test is to evaluate the observations of means from two related samples, here the two samples are pre crisis phase and post crisis phase. The null hypothesis of the test is "There is no significant difference in the mean of the two samples". The P-values are followed to interpret the results. The software used for data processing is SPSS. The results are discussed in the paper in the latter section.

Variables: After reviewing the literature, three variables are considered. In order to study the performance of the luxury market as a whole as well as sector wise, the variables are categorized into Net profit ratio (NPR), Return on assets (ROA) and Return on equity (ROE). The definitions of the accounting ratios are given in the table below.

5. Results and Interpretation

The financial crisis is merely known to make the organizations comparatively slow in terms of the manufacturing owing to the retarded demand of the market. People do turn reluctant to spend and they start behaving little conservative as long as the expenses can be postponed. But the executive of the luxury market have been propagating of the growth of the market perpetually. They claim that the market of high end goods sustained the recession to a great extent.

Profitability is the prime reason to run a firm. It elaborates the number of players in the market if is positive. Besides, it also draws the eyeballs of investors. The profitability of the luxury market is discussed as NPR, ROA and ROE as also supported by the literature. Ceteris paribus an investor and entrepreneur prefer profitability. It is a parameter of the financial performances of the firm. Harvey and Roper (1999) reported a statistical decline in Return on Equity prior to the Asian economic crisis. Claessens et al. (1998) pointed out towards significantly falling Return on Assets prior to the Asian crisis.

As far as profitability is concerned, this market could not sustain the previous standards of profit percentage. The mean values have shown that the sector as a whole has witnessed a loss making in the profitability ratios. The ROA and NPR have significantly slashed down at 5% and 10% level of significance respectively. Falling profitability reports that the entire sector may not be resilient to the crisis. The sector wise study would be a better evaluation of the market.

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Table 1: Statistics of Pre-post crisis financial ratios

Financial Ratios	Factor	Mean	t Statistics	Sig
ROA	Pre-crisis Post-crisis	9.098 7.441	2.441	.018**
NPR	Pre-crisis Post-crisis	15.881 9.293	1.979	.053*
ROE	Pre-crisis Post-crisis	17.998 15.751	1.458	.150

Table 2: Segment wise Statistics of Pre-post crisis financial ratios

Financial Ratios	Factor	Mean	t Statistics	Sig
Automobile and specialty sectors				
ROA	Pre-crisis Post-crisis	10.419 7.660	1.522	.159
NPR	Pre-crisis Post-crisis	7.143 6.737	0.213	.836
ROE	Pre-crisis Post-crisis	21.419 17.224	1.072	.309
Hotel, Leisure and beverages				
ROA	Pre-crisis Post-crisis	7.208 5.348	1.573	.131
NPR	Pre-crisis Post-crisis	30.466 12.152	1.896	.074*
ROE	Pre-crisis Post-crisis	16.199 13.113	1.217	.231
Household and personal care				
ROA	Pre-crisis Post-crisis	9.342 5.679	1.915	.082*
NPR	Pre-crisis Post-crisis	7.305 4.664	1.835	.094*
ROE	Pre-crisis Post-crisis	18.585 13.229	1.168	.027
Textile, Apparel and Luxury goods				
ROA	Pre-crisis Post-crisis	10.440 11.041	-0.842	.411
NPR	Pre-crisis Post-crisis	10.774 10.870	-0.111	.913
ROE	Pre-crisis Post-crisis	17.748 19.619	-0.834	.416

***significant at 1% level, **significant at 5% and *significant at 10% level

In automobiles section, the ratios keeping a track of profitability could not see any significant change in the pre and post phase of the crisis. Perhaps the explanation behind this performance may not sheer be the financial crunch but also the 2008 oil price shock which made the oil $140/barrel, an all-time high that impelled the consumers to resist the purchase of the automotive. While the financial ratios did not fall significantly, the impact of financial crunch is not found statistically on any of the ratios of this sector.

The ROA and the ROE in the luxury hotel, leisure and beverages have not been much influenced in the hard times. The statistical results demonstrate that the similar levels were maintained in the post phase in profit terms. The significant difference is being observed in the NPR as the ratio of 30.47% dropped down to 12.15% (approx.) in the second phase and the section needs to fetch more of receipts to corner the given levels of Net Profit Ratio.

The P-values of the profitability ratios have identified that the collapse in the net income have shown a prolonging impact on the ROA and NPR. Even after the cessation of the financial crunch, the return on asset and the net profit ratio have seen a steep fall. The probable reason of similar returns on equity in the two phases could be the easy access of the debt the firms which were availing in the market due to lack of investment opportunities.

For Textiles, Apparel & Luxury goods, dealing with the high end section of the society has predominantly proved to be resilient to the tuff economic times. There were no impressions of the conservatism among the public which could further shrink the levels of sales and gains there from. The profitability performance of the Textiles, Apparel & Luxury goods segment were not significantly different on any of the parameters.

6. Conclusion

The luxury market has always been known for the sheen. The story is not lucrative only to the customers, manufacturers, competitors and public at large but also for the investors. This zone has always been easy to get addicted but tedious to do without it. There have been theoretical explanations that these are not the concerns whose sales volume sink and float with the business cycle rather the extravaganzas are actually preferred even more in troublesome era so as to maintain the fair picture in the market and also a positive investment sentiment among the investors.

Despite a slight decline in the two sectors (Hotel, leisure and Beverages, Household and personal care), there still were Automobiles and specialty and Textiles, Apparel and luxury goods –that set an example by showing no variation in the ratios of profitability overtime. Another crucial conclusion of the study is that neither do any segment nor does the market as a whole came up with any sort of losses. Even when the profits were turning into losses for the big well diversified giants, the market and also the sector-wise markets were not distressed at all about the proceeds and the economic viability in these organizations. The conclusions can be drawn that for investors this segment could nowhere observe any statistical change in the returns earned by them i.e. in ROI. The ROI is not just determined by the earnings accrued to the firm but also many other factors are associated to that. For an entrepreneur, NPR has realized a diminished value in the second phase in the Hotel, leisure and Beverages, Household and personal care sectors. The possible reason could be these products are demanded by the income elastic people also which has led to the significant changes in the ratio.

The study has primarily studied the performance of the luxury sector in terms of profitability and the potential of the industry as a whole and also by dividing sector wise. The research has an implication to the following segments:

Entrepreneurs: There have always been numerous reasons which serve act as impetus for entrepreneurs towards the luxury sector (known for very high mark up, always profitable and indifferent to the economic shocks). This study has been made for them to define the profitability of the same and also offer them to choose the segment where they wish to.

Investors: The results of the statistical test have taken into account the NPR, ROA and ROE ratios pre and post financial crisis. Even if the existing and prospective investors show distinct inclinations. Both can conclude about the sector that may bring higher returns than others.

Management: The management of the organization is always keen to know the performance in the phase of downturn. This entity can also think of the potential of these segments that might be more profitable in such phase.

Researchers and academicians: The scholars who are interested to go for a detailed analysis of the luxury sector may consider the study and can pursue the further research.

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