

An Understanding of the Emerging Dynamics in the Luxury Ecosystem

Raghupriya A.* and Thiruchelvi A.**

ABSTRACT

The year 2020 is the most challenging period in the history marked with the intense humanitarian crisis topped with the deepening economic crisis. COVID19 pandemic has affected the consumers everyday aspects of life. Like many sectors, the luxury fashion sector is also facing unprecedented shift in their ecosystem. According to McKinsey GFI analysis(2021), the fashion companies will post a 90% decline in economic profit in 2020 after a rise of 9% in 2019. For the luxury industry the pandemic will accelerate the revamping trends that were in action prior to the crisis such as more digitization, customer empowerment and social responsibilities. Currently a lot of research related to the luxury fashion industry is available, but through this study we aim to collate our understanding of the emerging dynamics in the luxury fashion industry and provide an outline of the revamped luxury ecosystem and recommend business strategies with focus on agile, flexible, ethical, culture-sensitive, omni-channel presence and enhanced use of data and analytics and customer-centric. Though there is no one strategy that fits for the whole sector, the business should tailor their strategies based on their operational resilience and capabilities for being relevant and to emerge from this unexpected crisis..

Keywords: *Luxury industry, COVID19, Consumption trends, Digitization, Data analytic, Agile SCM.*

1.0 Introduction

The concept of luxury has been continuously evolving. “What one generation sees as a luxury, the next sees as a necessity.” (Anthony Crosland). The global personal luxury industry has seen a steady trajectory at a pace of 6% CAGR since 1990's and was worth over \$308 billion as of 2019 with China accounting for 90% of the market's growth in 2019 (Bain, 2020). The Covid-19 pandemic has hit all the industries and luxury is no exception. With social distancing, rise in unemployment and consumers becoming more conscious than conspicuous, the personal luxury market witnessed a decline of 23% in 2020, the largest since recorded (Bain, 2020), with some iconic luxury retailers becoming bankrupt. The companies that have already experiencing distress have had a harder impact because of the pandemic. The survey of GLEN members by the Luxury Institute highlights the current luxury environment and predicts varying degrees of projections for 2021 across the categories with rise in sectors such as consumer wellness and technology, home appliances; fall for retail and flat level for travel and hospitality, automotive and fashion apparels and accessories. Relevance being the new legacy, the future fashion industry should focus on digitization and sustainability (BoF, McKinsey, 2021). The luxury retailers must be ready to embrace the disruptive technologies, adapt the omni-channel strategy, understand the changing roles of consumers and align their business models and value proposition according to the changing ecosystem.

Currently a lot of research are available for both the impact of pandemic across various fields and also the trends in luxury industry. Through this conceptual paper, we present our understanding of the luxury market scenario by collating secondary qualitative data obtained from the relevant journals and reports from global consulting firms.

*Corresponding author; PhD scholar, Department of Management Studies, College of Engineering Guindy, Chennai, Tamil Nadu, India. (Email: raghupriya28.sa@gmail.com)

**Assistant Professor, Department of Management Studies, College of Engineering Guindy, Chennai, India. (Email: thiruchelvi_y@annauniv.edu)

The aim of this article to present the new age luxury ecosystem and propose the need for business to strategize on the relevant trends which serve as silver linings to gain brand momentum to revamp from the pandemic impact.

2.0 The Theoretical Foundation

In Emergency Committee meeting, the Director General of WHO stated that "The COVID pandemic is an unanticipated rare health crisis, the effects of which will be felt for decades to come." This immense and prolonged epidemic led to unexpected and unprepared economic shock with different industries affected in varying degrees in three major areas: financial, supply value chain, consumer market, each of which is inter-linked.

2.1 The impact of pandemic on the consumer behavior

The Covid-19 has led to a perceived anxiety related to health and income patterns which has led to a decrease in the quality of life and emotional state of the consumers(Lai, 2020). This resulted to broader repercussions of fear and this is reflected in their uncertainty in spending decisions(Loxton, M et al, 2020). There is a shift in buying behavior with more focus on essential and safety items than on emotional and hedonistic goods as anticipated by the Maslow's Hierarchy of needs. These behaviors were exhibited even during the past crisis and was reflected in the form of panic buying, herd mentality and discretionary spending(Loxton, M et al, 2020). In the time of crisis, customers tend to closely watch how companies cope throughout in terms of employees and social responsibility(Buheji and Ahmed, 2020). The 2020 Edelman Trust Barometer signifies the fact that during the crisis brands can either build a new level of connection with customers or lose the relationship forever. There has been a slow transformation by the sector but a growing demand for digital presence by the luxury consumers even before the crisis(Kim and Ko, 2012). This crisis will only increase the customers expectations as they are more addicted to convenience and omni-channel experience(Klaus and Zaichkowsky, 2020) which has led to certain industries adapting the disruptive innovative technology to enhance the customer experience(Klaus, 2020a). Though the pandemic has affected the luxury sector economically, it provides an unique opportunity to the industry if they focus on employment, emotions and expectations of the consumers(Klaus et al, 2020)

2.2 The luxury industry

The notion of luxury has been evolving over a longer term on the basics of several value terms related to the consumers' perspectives(Cabigiosu, 2020). Traditionally, luxury was visioned with elegant shops and luxurious aesthetics with digitization and customization never a part of brand strategy. Some of the players in this sector were hesitant about introducing customization owing to the fear of brand dilution, it is the consumer who prefer to experience engagement, entertainment and interactive shopping though online. The study by Yoo, J and Park, M (2016) adopted the "Consumer-Perceived Value Tool" (CPVT) identified that through mass customization the luxury brands could build a better customer relationships by providing hedonistic, utilitarian, uniqueness, self-expressive, and creative achievement value with no negative impacts on their brand image. Also the branding literature states that though there have been clear distinction between luxury and mass products in the past, the boundaries are getting blurred since the recent past and every product has a piece of luxury in it. The decrease in household size, increased income and change in lifestyle influenced by education, technology and travel has resulted in consumers 'trading up' and the brands 'trading down' to welcome and retain the new affordable consumers. Even before the crisis the luxury sector was going through the changes but was slow and not able to fulfill customers' desire to buy luxury products and services online. Even though, McKinsey report(2018) states that by 2025, luxury good purchase online will be 20% and influence by online channels on all the purchases will be 80%, it has been

identified that the online channels of some luxury brands do not deliver the experiences that the customers desire. The epidemic has now defined digitization as the strategy for the future and luxury brands should embrace and enhance their digital presence and shopping facilities for customers (Bain, 2020). The retailers need to adapt the online technology to enhance their supply chains and can use the communication platform to show how the brands act and care for the society, this would lead to an increased brand loyalty (Sender, T. 2020). In an attempt to handle the crisis and to recover from heavy losses, the brands are developing strategies to emotionally connect with their customers (Siddiqui, B. & Ganjoo, M. 2020) and communicating the responsible actions, product innovations and the price adjustments to gain the brand trustworthiness and loyalty (Xie, J. & Youn, C. 2020). The performance analysis in the second quarter of 2020 signifies that the luxury brands are open to more digital marketing and the level of online sales will rise in the future (Peiyu, W. 2020).

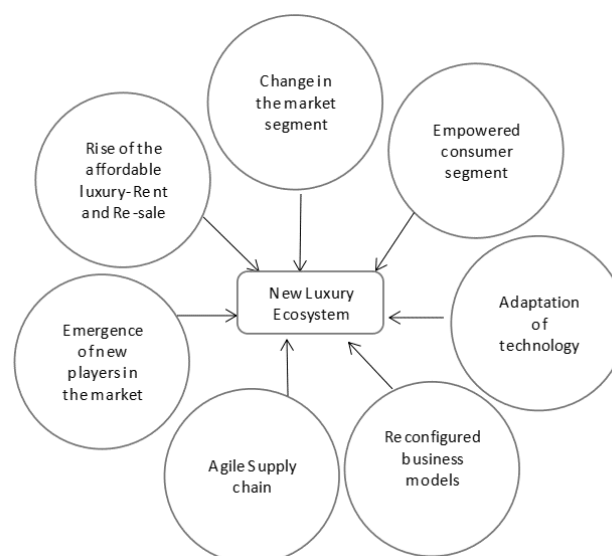
The luxury industry had witnessed some economic downturns in the past starting from the recession due to World War II, 1990s Gulf oil crisis, the dot.com, 9/11 and the 2008 recession. Despite the fact that there was a decline in the luxury spending during crisis, the trajectory is not linear or uniform and each of these times, the industry has not only emerged but strengthened by re-aligning and re-focusing on the outstanding quality, fostering customer experience, improving marketing channels, product innovation and capital investment (Reyneke, M. et al, 2020).

Recently the luxury market is gaining more attention among the scholars and lots of articles related to various evolving concepts are available. Even as we present this study we expect some evolution in the industry. Based on the existing literature, we have attempted to represent a model of the new luxury ecosystem of the millennials marked by more empowered and engaged consumers who prefer casual than glam, online than offline, product value than price, sustainability and responsibility, local culture and heritage. We recommend the significance of digitization, co-creation and sustainability, measurement of brand value equity considering the whole omni-channel as part of business strategy to sustain in an era of “Luxury 4.0” term from ‘The age of digital darwinism’ (McKinsey, 2020).

3.0 The new Luxury Ecosystem

In this study, we have presented a framework for the new luxury ecosystem and we will discuss each arena in detail in the following sections.

Figure 1: The New Luxury Ecosystem



3.1 Change in the market segment

The UN's COVID-19 Immediate Socio-Economic Response framework warns that “Even though the global health is mainly affected by COVID-19 but also affects the core society and economy.” The impact varies from developed to developing countries. There is a pressing need to focus on the social consequences related to job losses, depression, stress, domestic violence and so forth. (Aneja, R. et Ahuja, V, 2020) This results in immediate focus on SDGs by the governments and UN, as the development trajectories mainly depends on the the countries' measures. The UN has extended its full capacity to its 131 countries and supporting 162 territories in developing mitigation plans.

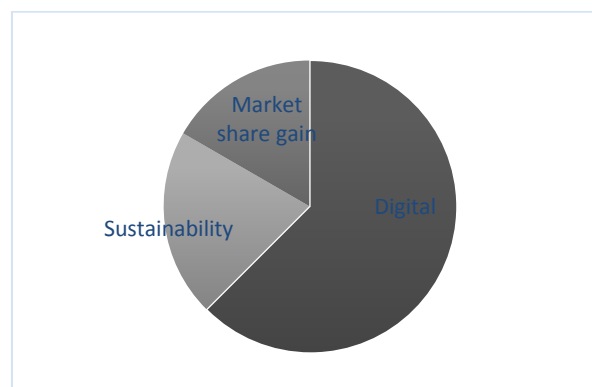
In the economy sector the effect on migrants, job losses and poverty varies disproportionately globally. Like many sectors, the luxury is also facing unexpected economic crisis. In the BoF and McKinsey 'State of Fashion survey 2021', the business executives had a divided outlook on the pandemic recovery across the sector and geography with 45% of the respondents stating that COVID19 and the economic crisis being the biggest challenge in 2021. Increased unemployment, inequality, lockdown and travel restrictions which has heavily influenced consumers psychologically resulting in reduced buying behavior and constrained spending power leading to diminished demand. Owing to which the global sales is expected to go below 2019 level by as much as 15%.

The recovery timeline is expected to vary between third-quarter of 2022 to third-quarter of 2023 based on government trade and travel regulations, improvement in the geographical markets led by China followed by Europe and USA.

3.2 Adaptation of technology

According to 'The age of digital darwinism', the digital trajectory leads to an emergence of Luxury4.0. The pandemic has led to the lackadaisical move towards online innovation to a sprint as brands started focusing on their only source of revenue: e-commerce. The global fashion e-commerce market is expected to grow from \$549.55bn in 2020 to \$668.1bn in 2021 at a CAGR of 21.6% mainly because the sector has adapted the new normal in their operations and resuming from the pandemic impact. This growth is also attributed to the rise in use of internet and smartphones (Digital 2019 Global Overview Report). Digital is seen by a third of executives as a silver lining that presents the biggest opportunity in 202 (BoF, McKinsey, 2021)

Figure 2: Top Three Answers of the Fashion Executives



(Note: SOURCE: BoF McKinsey State of Fashion 2021 Survey)

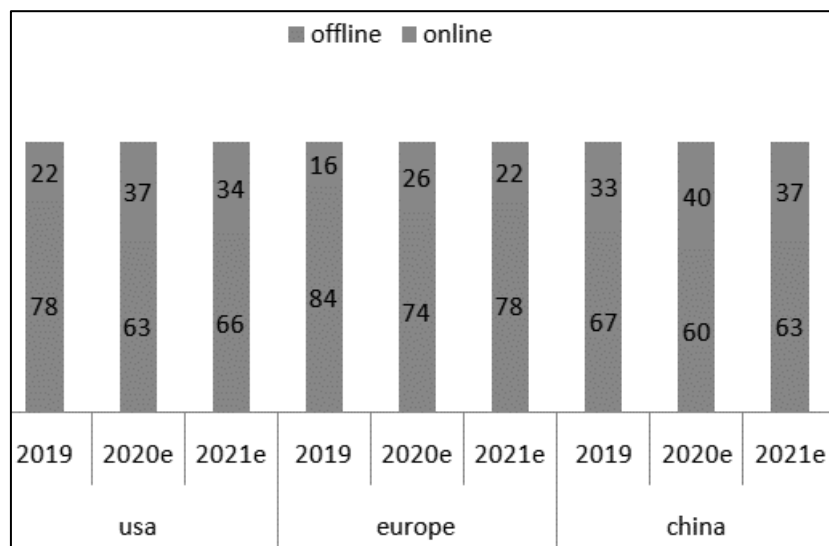
It is expected that by 2025, one-fifth of the personal luxury sector will happen online with variations in purchase from product to product. Luxury shoppers of all age groups are embracing digital as a consumption channel moving from laptop to smart phones. The main challenge lies in how

the marketers could translate the art of story-telling through a smart device. The acceptance of digital reality is happening in the luxury sector which is seen through the change in brands promotion investments and adopting of new technologies such as AI, scanners, VR outfits and automation tools which provides highly relevant and personal consumer experience(Fashion E-commerce Global Market Report 2021, Business Research Company)Fashion shows, 3D virtual exhibitions and interactions, conversational bots serve as a powerful tool for digital communication. The e-luxury business models are evolving with e-retailers(Matches Fashion),marketplaces(Farfetch) and tech companies(Stitch Fix)(McKinsey, 2020).The most forward looking brands use consumer data and adapt AI in enhancing the front and back-end operations. According to CEO, CFDA; this pandemic has also introduced Phygital as the future of fashion weeks which is evident from the virtual fashion shows organized in the main fashion cities with live audiences owing to the travel ban of luxury tourists. Though this virtual fashion weeks worked for lot of brands, some still need a physical presence.

Apart from creativity, digital storytelling and omni-channel, there is a rise in the use of influencer marketing which has proved itself more important than ever in this year. Still, measuring the value of brand visibility across social media is a primary challenge for brands to estimate ROI. The Media Impact Value is a key global strategy to determine brand's ROI and rank among competitors. According to Launchmetrics, brands make hefty investments in the following channels: Influencers, Celebrities, Partners and Media(Paid, Earned and Own).

As online penetration accelerates and shoppers demand ever-more sophisticated digital interactions, fashion players must optimise the online experience and channel mix while finding persuasive ways to integrate the human touch.

Figure 3: Expected Share of Online Sales



(Note: SOURCE: BoF McKinsey State of Fashion 2021 Survey)

3.3 Empowered consumer segment

The luxury industry is witnessing a trend in their consumer segment: demographically(millennials, GenZ, HENRYs),geographically(rise in the Asian market), psychologically(social media influencers, KOLs used for digital campaigns) and behaviorally (focus on brand value, sustainability, social ethics, purchase behavior). For the marketers, this pandemic has amplified the need to focus and capitalize on the segment patterns. In the global battle with pandemic, the everyday aspects of the consumers have changed drastically making them a conscious spender

than a conspicuous consumer. There was a slow shift towards digital shopping which has increased to 60% or more during the quarantine (Nielsen research, 2020). Even in a typical brick and mortar market like Hong Kong, the consumers quickly moved to e-commerce apps. In the Asian region, social media also served as a platform for COVID19 updates.

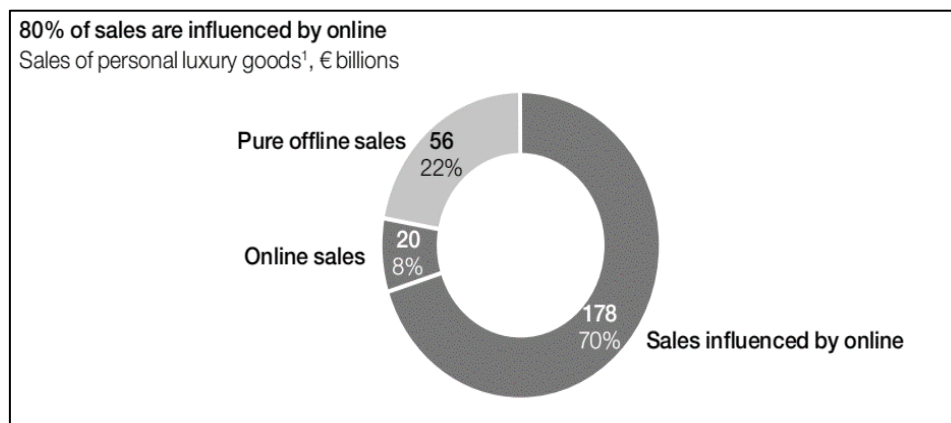
During the crisis, there is an increase in demand for social responsibility and sustainability from the luxury brands and their involvement are being carefully assessed. The top luxury brands are also contributing to the fight against COVID through product or monetary donations. These socially responsible measures by the brands will increase the consumers brand trust, loyalty and emotional bond for a longer time post the turmoil (Bain, 2020) and these are communicated via digital channels (paid, earned and owned). Nearly two-thirds of the consumers expect their brands to be responsible towards their employees during this crisis and state that they would either stop or significantly reduce their purchase with brands mistreating the employees (McKinsey, 2021).

The new age luxury market is dominated by the millennials and Gen Z who will make up for a 40% market share by 2025. There is also a rise in the medium and medium-higher groups (HENRYs-High Earners Not Rich Yet) who are affordable and aspirational and view luxury as an investment. The luxury brands try to attract and retain them through the premium entry products (McKinsey, 2020). The millennial HENRYs especially, are tech-savvy, with better purchasing power and use social media for buying decisions. The BCG study stated, this new segment appreciates collaboration of KOLs and brands, consider re-sale value, focus on 'silent luxury' (craft and heritage rather than glam) and prioritize sustainability (McKinsey, 2020). A study from Nielsen states that nearly three-quarters of the millennial are willing to spend more for products that come from a sustainable and socially responsible brands. With digital presence, sustainability along with process transparency will gain brand trust from consumers. Brands are competing for this new age mindshare and focussing on engaging with influencers who are in line with their brand values. The spike in TikTok popularity during lockdown, has spurred a new thought for luxury to engage with this audience via this channel.

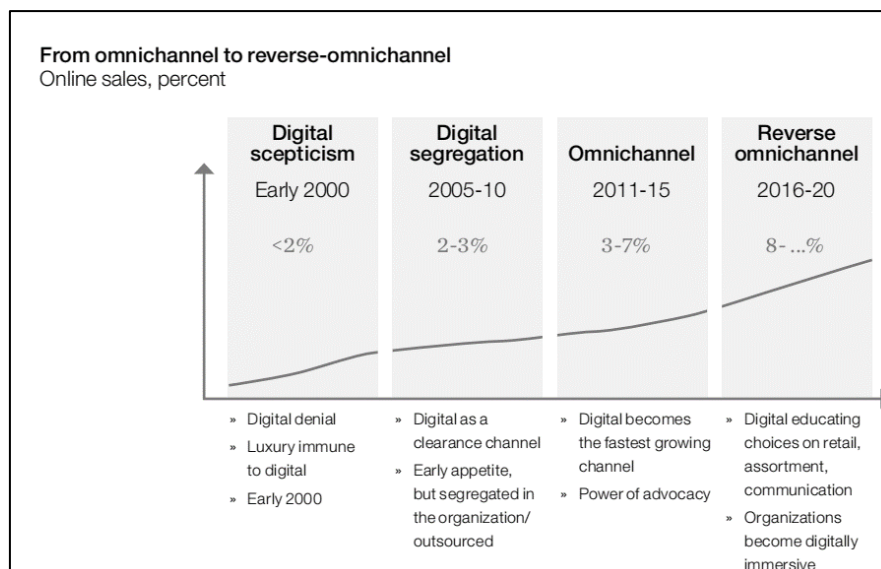
All luxury consumers are going digital, this trend is not just linked with millennials. Baby boomers spend 16.4 hours in the Internet and 75% of them use social media as compared to 17.5 hours and 98% use by the millennials (McKinsey, 2020). With increased online purchase the customer wants to engage via multiple digital points and experience the product customization. In the past 5 years, the number of touch-points influencing consumers purchase journey have become thrice. In case of Chinese luxury consumers the points are estimated to be around 15 (Euromonitor, Forrester and McKinsey, 2020). The customer also expects this continuous and coherent brand relationship via these digital points, even as they travel from one geography to the other. This is still a challenge for brands who are organized around channels and geographies. Daigou, the act of shoppers outside China market buying luxury goods for consumers back home, is an indication of the consumers' willingness towards digital touch points across boundaries. The use of WeChat by Chinese consumers for the entire purchase journey is another example of the rise in digital luxury shopping.

The luxury brands should be willing to accept the concept of co-creation not only in production development but also in brand content generation without affecting the core brand identity. The brands have to develop strategies to make the consumers the brand ambassadors. The digital luxury is turning into a C2C economy with the greater engagement and empowerment of consumers who are not just a purchaser but a creator, meta-voice and a propagator (Liu-Thompkins et al, 2020).

The impact of digital experience makes consumer set expectations on online shopping and also the same in the physical store. It is time for reverse omni-channel where stores are expected to match the level of online experience. Digital is no longer a medium of mere sales or communication but a source of inspiration to re-design the store and re-focus on the customer experience.

Figure 4: Sales Influenced by Online

(Note: SOURCE: Euromonitor, Forrester, McKinsey Annual Reports)

Figure 5: Reverse Omnichannel

(Note: SOURCE: Euromonitor, Forrester, McKinsey Annual Reports)

Another dynamically and fast- growing trend in luxury sector is the “Experiential luxury” which along with social media influencers are gaining momentum. Social distancing and lockdown had made popular brands like Louis Vitton, Saint Laurent, Versace and Burberry to name a few use nostalgic marketing campaigns via social media channels(instagrammable moments) and develop product designs based on nostalgic theme to attract the boomers and the millennials equally.

The lockdown has resulted in revenge spending which is observed in the China market as the situations are settling down. The consumers have started to resume their shopping behaviors with the alleviation of the situation and we foresee a higher spending than before from China, given the fact that traveling is still restricted. With big data and machine learning, the luxury brands can improve the authenticity and customer relationship. In early days, Louis Vitton used to send personalized product suggestions to their customers, the same unique personalized recommendation can now be achieved using Big data analytics and this marks the era of contextual marketing where each customer is unique in each situation.

The new age luxury consumers embrace ethics, crafts, heritage, technology and prefer casual

over glam. This pandemic has created an opportunity for the industry to reconsider 'rest of the world' strategy to focus on other emerging markets than China and focus on engaging and empowering consumers.

3.4 Rise of the affordable luxury- Rent and Re-sale

The re-sale or re-commerce market for the fashion goods were booming even before the pandemic. Consumers started valuing their once purchased luxury items as not only a style factor but a trade-able asset. The online retail site such as The RealReal, Poshmark, Depop and ThredUp are boosting of a growing amount of consumers in this sector which serves as a means of financial security especially during the time of this epidemic. The luxury apparel and accessories market reached \$24 billion in 2019 and is expected to reach \$53 billion by 2023. Even though the millennials and GenZ dominate this sector, Boomers and GenX are also embracing this market as a means to clear-up their closets. The RealReal holds the authenticated designer brands such as Chanel, LV and Valentino. While the ThredUp holds the consignment of around 45,000 brands from Gap to Gucci, the sites like Poshmark and Depop provide a C2C transaction platform. According to ThredUp report 2020, over the three years the resale business grew at a speed of 21 times as that of new apparels business with millennials and Gen Z holding a market size which is 2.5 times that of the boomers and GenX. This pandemic has led to a 50% increase in the business size. Also, the legacy retail players have tapped into the resale market to attract the young consumers which is witnessed by the tie-up of retailer Macy with ThredUp.

The re-sale market has also been hit by the pandemic. According to Milton Pedraza the founder of Luxury Institute, the supply of the consignment has been increasing with consumers ready to sell their used fashion goods but the demand is far less leading to difficulties in inventory management. The RealReal is witnessing a downward slope and the resale business also looks for way to re-model their business and are connecting with their customers virtually. Pedraza also points out that the viability of resale business in European and Asian markets and the big brands like Gucci and Chanel will invest in pre-owned business to avoid counterfeits in the market.

With environment and economy conscious consumers on the rise, another viable option to experience luxury is through renting. Renting becomes the new owning. There is an increasing number of online apps and platforms which offer an option for renting luxury items for a subscription. With this the consumers can flaunt the luxury for a specific period with less investment and maintenance. Renting is extended across various sectors of luxury from homes (AirBnb, Homeaway), clothing (Rent n Flaunt, Le Tote), Accessories (Bag, Borrow or Steal), Cars (Rolls-Royce Drophead, Turo) etc..

3.5 Emergence of new players in the market

The introduction of Amazon's Luxury Stores and the Farfetch China are two notable entrants to the luxury industry in the pandemic era.

The launch of a section on Amazon's mobile app called the Luxury stores in the fashion sector on September 2020, has been an opportunity for the already struggling fashion department stores, as it serves as a new channel for distribution. The Amazon luxury stores provides an efficient gateway for designers who find it difficult to connect with the consumers and the retailers who are facing bankruptcy. The Amazon's luxury stores will provide a 360-degree interactive window for shoppers to view items on different body types and skin tones. It has also stated it provides the retailers the option for independent decision regarding product assortment, price, delivery and service options. With its strong customer database and technology adoption, the Amazon luxury stores will play a dominant competitive role in the luxury business.

Another new entrant in the luxury industry amidst the pandemic is the creation of online

marketplace Farfetch China, the most high profile luxury e-commerce deal with \$1.1 billion venture between Richemont, Alibaba, Artémis and Farfetch and a joint investment of \$600 million by Alibaba and Richemont in Farfetch resulting in a quarter percent stake in Farfetch's operations in China.

During the period of extended lockdown with increased consumers purchase through smart devices and reduced store footprints, Farfetch's e-commerce share of the global luxury market nearly doubled from 12%-23%. This resulted in a staggering market capitalization rise by 475% with its first ever profit during the fourth quarter of 2020.

This deal has led to dedicated Farfetch shopping channels on Alibaba's T mall Luxury Pavilion, Luxury Soho online and cross-border marketplace T mall Global. For Richemont, this is an opportunity to tap the China market and emerge as a global digital competitor to its rival LVMH who has a strong digital presence, 24S and Lyst, since 2017. For Alibaba, who have been tapping the US market with its B2B selling program and the use of Western influencers in social media promotions, this deal would make it a global competitor to Amazon in the luxury space. Farfetch would benefit from Alibaba's strong data capabilities and mark a footprint in the East and South-east Asia.

3.6 Reconfigured business models

The business models are focusing more on vertical integration and omni-channel strategy to emerge victoriously from the pandemic. From Gucci to Hermes and fast fashion retailers like Zara and H&M were slowly moving towards vertical integration even before the pandemic to avoid bankruptcy and better value chain management. Though this sector is composed of consolidation by big players, the pandemic has proven that there is still opportunity for young independent and local players. The focus on serving the local market with the local supplies and not tourist dependent is gaining momentum as this serves as a best recovery from the pandemic. The elite and the millennials are getting inclined more towards local artisans and craftsmanship. So the luxury models should focus on culturally relevant and building up of local community craftsmanship (Luxe Digital, 2020). The marketers should work collaboratively with the Chinese market experts and incorporate brand value aligned KOLs, Asia Weibo and Douyin to make domestic communication to be successful in the Eastern market (Launchmetrics, 2021). The JIT management of Industry 4.0 along with digital enhancement will lead to an agile and responsive operations of the luxury sector without diluting the brand identity resulting to Luxury 4.0 offering 3D printed products to their consumers in the next five years as stated by McKinsey survey report. Also, Sustainability growth strategy is gaining momentum which is emphasized by the Forbes report which signifies millennials concern about environment (42%), animal welfare (26%) and baby boomers primary concern for ethical manufacturing (32%).

3.7 Agile supply chain

The risks due to disruptions (natural or man-made) has a significant impact on supply chain. The disruption in one link of the supply chain will move downstream if there are no proper buffers and adequate lead times leading to a ripple effect. In an era of globalization, a small epidemic arising out of a geographical area will disperse across regions. Ivanov (2020) identifies three characteristics of an epidemic outbreak: (1) unpredictable disruption period, (2) the ripple effect and (3) consequent disruptions followed in the logistics, demand and supply. With asynchronous nature of epidemic spread and variation in disaster management followed by countries, we observe a unique angle of disruption with varying levels of period and intensity in various countries either as a ripple effect or as a lockdown. With China being the dominant player on the global luxury industry, the supply chain of this sector was temporarily impacted during the rise of the pandemic. This highlights the complex and interdependent nature of this sector. Also, we identify that there has been a disturbance in the supply and demand with consumers changing or cancelling the demands of the non-essential fashion goods. This reflects the impact of epidemic on the upstream and downstream supply chains. The business

should strategize on implementing agile SCM with adequate inventory management for an effective value creation (McMaster,M et al.2020).

4.0 Discussions

This study highlights the following trends for the luxury brands to rebuild its business post the pandemic:

- Brands should focus on brand momentum
- Measure brand equity value by considering all the omni-channels
- Build upon Sustainable Ethical Growth strategy
- Develop agile and flexible supply value chain
- Emphasize on local crafts and heritage
- Communicate with consumers for a better exchange of data and improved sales and improve emotional connect
- Collaborate with brand value aligned influencers
- Embrace technology and data analytics
- Even though the market witnesses mergers of big players, there are opportunities for young independent local players
- Diversify the market portfolio by considering the rest of the world strategy

5.0 Conclusion

According to Altagamma foundation,“The year 2021 will be the beginning of recovery from recession and we can expect a pre-crisis return from 2022.An average growth of 14%across all luxury sectors, with 22%increase in online and 18%from Chinese market has been predicted.”There is a greater scope for the use of Artificial Intelligence and Big Data and the brands who are early adaptor of this technology will gain better customer-relationship and emerge a stronger player in the market. Through this framework of the new luxury ecosystem this study identifies the key trends for an evolutionary future.Digitization and Sustainability are the silver linings to overcome this global crisis era.The luxury sector will be more dynamic, reactive, adaptable and push their creative limits to emerge stronger.

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