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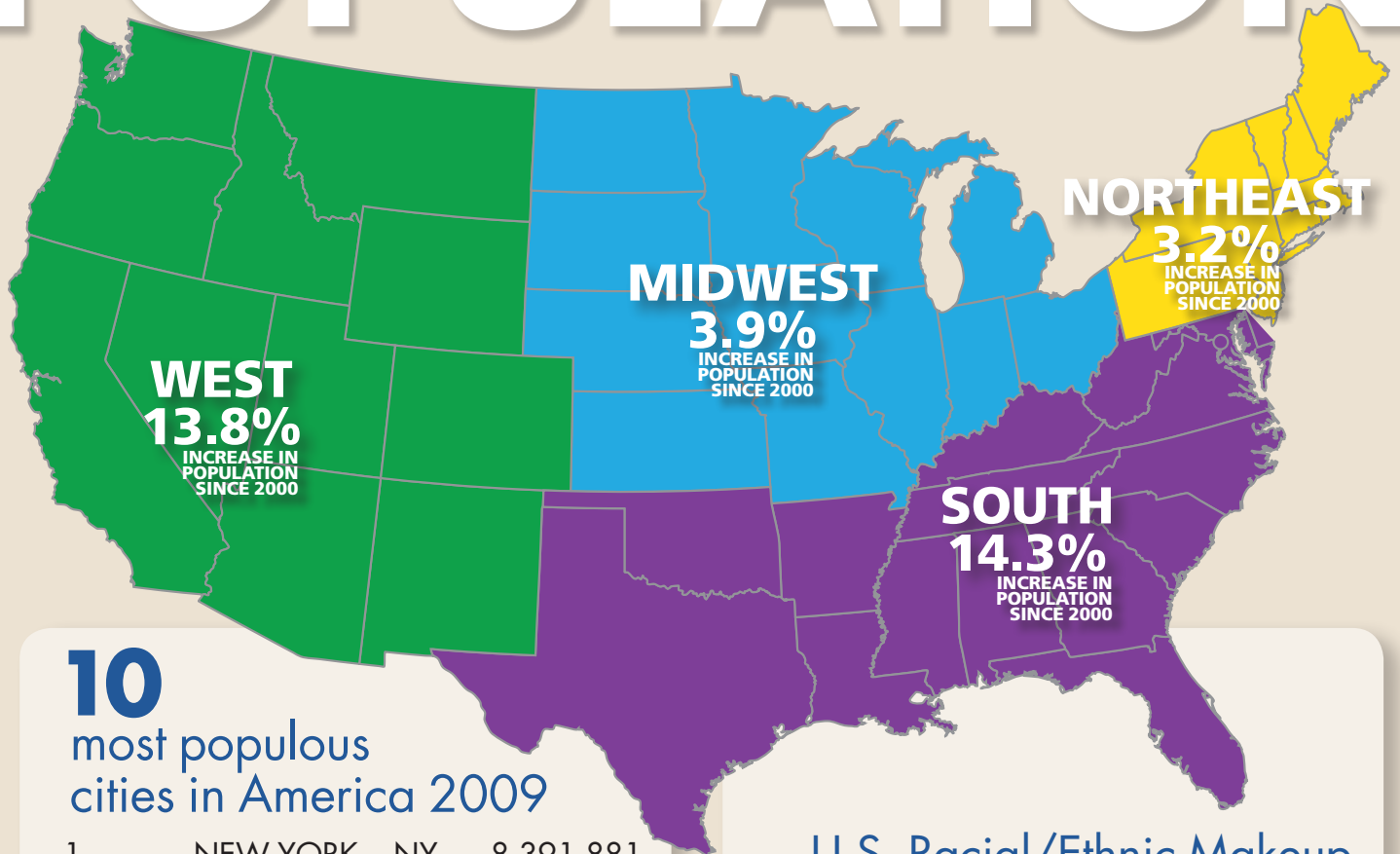
TM

SPECIAL REPORT



U.S. MARKET
WHERE IS IT GOING?

POPULATION



10

most populous cities in America 2009

1	NEW YORK, NY	8,391,881
2	LOS ANGELES, CA	3,831,868
3	CHICAGO, IL	2,851,268
4	HOUSTON, TX	2,257,926
5	PHOENIX, AZ	1,593,659
6	PHILADELPHIA, PA	1,547,297
7	SAN ANTONIO, TX	1,373,668
8	SAN DIEGO, CA	1,306,300
9	DALLAS, TX	1,299,542
10	SAN JOSE, CA	964,695

Marriages 2000-2009

2009 -	2,080,000
2008 -	2,157,000
2007 -	2,197,000
2006 -	2,193,000
2005 -	2,249,000
2004 -	2,279,000
2003 -	2,245,000
2002 -	2,290,000
2001 -	2,326,000
2000 -	2,315,000

U.S. Racial/Ethnic Makeup

White:	244,298,000	▲ 7.1%
Hispanic:	48,419,000	▲ 37.1%
Hispanic and One Race:	47,655,000	▲ 36.9%
Black:	39,641,000	▲ 11.0%
Asian:	14,014,000	▲ 32.3%
Two or more races:	5,324,000	▲ 26.6%
American Indian or Alaska Native:	3,151,000	▲ 18.3%
Native Hawaiian/ Other Pacific Islander:	578,000	▲ 25.0%

2010 U.S. Population:

308.7 million

2000 U.S. Population:

281.4 million

+9.7%

Source: 2010 U.S. Census

Topping the important issues facing luxury retailers today is not just whether the recession is over, but how long its inhibiting effect on consumer spending will linger. From the low-end of the economic strata to the upper levels, shoppers' attitudes toward what they spend money on, how much and how often, have changed. And even with a return to positive economic forecasts, they are not planning to return to the way they lived and shopped before. This is not your prerecession shopper!

"Coming out of the recession," says Paco Underhill, chief executive officer (CEO) of Envirosell and the author of the new book, *What Women Want*, "all of us realized that our cars were too big, our houses were too big, our debts were too big, our bellies were too big and we needed to go on a diet. And it was important for us, whatever our place in the social spectrum, to spend within our budgets." Part of what that meant, he goes on to say, is that "the luxury market consumers for a year or two realized that conspicuous consumption was bad

manners. And now that they are back in the market, they are shopping a little differently than they were before."

ON THE ROAD TO RECOVERY?

The answer to whether or not the U.S. economy is truly on the path to recovery depends on which statistics you look at and which experts you talk to. Strong first-quarter sales following record year-end results seemed to indicate happy days are here again — Bain & Company forecast an 8 percent rise in luxury spending in 2011, with the U.S. remaining the world's largest market for luxury goods. But then again, the government reported that from January through March, first-quarter growth slowed to an annual rate of 1.8 percent and unemployment claims rose in April. Amid all these schizophrenic statistics, it's hard to know whether the worst is behind us and if luxury really has regained its luster.

Based on the benchmarks established by the National Bureau of Economic Research (NBER), a committee



ECONOMIC DICHOTOMY

Coming out of the recession, the biggest change facing the luxury sector may be the way the consumers are now approaching spending. | BY PHYLIS SCHILLER AND JOYCE KAUF

of academic economists, the Great Recession ended in June 2009, marking the conclusion of the longest economic downturn in United States history since the Great Depression. But whether that news filtered down to the shopping public — and when — is open to debate.

“People really didn’t care what the eggheads were saying about the recession being over; they still felt it. However, that began to change in early 2011,” explains Ken Goldstein of The Conference Board, who personally is of the opinion that the recession is, in fact, over.

“It’s certainly not over for the 8.9 percent who are still unemployed,” emphatically states Robin Lewis, chief executive of The Robin Report and professor at the Fashion Institute of Technology (FIT). “There is a great swath of the population who have not seen wage increases in a long time and if they have, it has been very little. It’s a very down economy.”

Continues Lewis, “I don’t have a vision of a robust future anytime soon. There is no business investment. I don’t think we’re going to see a recovery until 2015 and it’s not going to be the same as before the bubble years.” According to Lewis, the “big picture” long term will be decisive in determining whether the U.S. can continue forward as an economic powerhouse and leader. “Seventy percent of the U.S. economy is based on consumption — we do not create value; we consume it. If we can’t get off the consumption addiction that is driving us, we will fall like the Roman Empire.”

Edie Weiner, president of Weiner, Edrich, Brown, Inc. and a leading futurist, scoffs at the idea that the country even experienced a recession. “It was rather a fundamental transformation of the U.S. economy.” She argues that it didn’t behave like a recession, citing the fact that it did not exhibit a failure of business or industry or a “total decline in demand.”

Weiner identifies several factors that contributed to this upheaval in the U.S. economy:

- Baby boomers have not produced the expected “huge bump” in economic growth. Rather than spurring economic activity in retirement, they have to continue working to compensate for declining portfolios and dwindling savings.
- Many of the jobs lost will never come back. Even if people find jobs, many are earning less.
- People are living longer. They need money for retirement and to “sustain the incredibly high rising cost of health care.”
- Disposable income dropped as many people who previously leveraged their home equity now no longer have equity or easy access to credit.
- Recent graduates have the highest debt levels ever recorded as a result of the “incredibly galloping costs of education.”

AFFLUENTS OPEN THEIR WALLETS...BUT

“The recovery proved more resilient than anyone expected,” says Milton Pedraza, president of the Luxury Institute, citing the “global demand for U.S. products from innovative companies such as Google, Apple and Facebook. The affluent and ultrawealthy have done phenomenally well. Luxury is cyclical and dramatically outperforms in upturns and drops dramatically in downturns. The top half has recovered nicely but they haven’t gone beyond the peak of 2007.”

While Pedraza observes that the “wallets of the wealthy have opened,” the same is not true for mainstream America. “There are millions of millionaires,” says Weiner, pointing to the fact that never before have we had “such a lot of people with a lot of money to spend.” Still, there is a “huge squeeze on consumption on those in the middle,” while the rest of the population is basically at maintenance level.

“The luxury segment,” Lewis explains, “is driven by the stock market and financial markets — which are an anachronism. It says nothing about the economy — it’s Las Vegas.” He agrees that spending by the wealthy is increasing, but points to the psychological factor that the recession has embedded into their minds.

Christopher Ellis, managing member and president of the Boston-based Consensus Advisors, attributes the surge in luxury purchasing to the “feel-good attitude that has been created by virtue of the colossal, colossal government spending finding its way into corporate profits but not creating jobs. The stock market is very buoyant — people are feeling wealthy and the zero interest rates affect everyone. They are paying minimum capital gains taxes. They’re spending their monster bonuses.”

“When you move out of the stratosphere of the top-end luxury consumer, I don’t see healthy growth. Everyone is broke. Municipalities have no money. What happens next? I don’t know,” says Ellis. “I don’t see where the fiscal ship will right itself. In 2008, when everyone was terrified, there was a moment of truth. The economy was based on phony real estate — the anchor driving the economy down just as it was driving it up. People would have taken the medicine then — we needed radical surgery and pain to excise the ills of the naughty. The solution, however, was made out of freshly minted dollars.”

While some experts look to the emerging economies as the new luxury frontier, Weiner is “always optimistic about the U.S. It is a hotbed of entrepreneurial activity and the hallmark of resilience in the world. We have grappled with multicultural issues since our founding, something that many other countries now face. It doesn’t matter if the Chinese economy becomes the largest in the world. Ultimately, it is about the ability to absorb aspirations and dreams and turn them into creativity and invention.”

SURVEY SAYS

As far as the gilt-edge shopping sector is concerned, while there is light at the end of the tunnel, it still isn't shining quite as brightly as in the prerecession days for at least a chunk of the population. According to a recent Deloitte survey, 43 percent of Americans feel the economy is still in a recession. But then again, nearly half — 45 percent — of households earning \$100,000 or more indicate their confidence in the economy has improved over the past six months, compared to 24 percent among those earning less than \$100,000. A mid-April Gallup poll reported that 31 percent of those surveyed earning \$75,000 or more believe the economy is growing; 52 percent in that group think the country is in a recession or depression. The Deloitte study also reported that households are paying attention to events that could curb their willingness to spend. More than seven out of ten respondents — 71 percent — cite concerns about higher energy prices, up from 54 percent at this time last year and nearly one-half — 47 percent — point to higher medical costs. Additionally, 44 percent indicate political unrest in other countries is a factor that could cause them to lower their spending.

On a more positive note are the results of the sixth annual American Express Publishing and Harrison Group survey of almost 1,500 households representing the top 10 percent of the income spectrum. The just-released 2011 Survey of Affluence and Wealth in America concluded that for the first time since 2007, significantly more affluent and wealthy American families will be substantially increasing spending in 2011 in 18 luxury categories. The findings include:

- The percentage of households planning to increase their spending is up 87.5 percent over 2008, while 2011 has a 25 percent increase over 2009–2010. Over 45 percent of America's wealthiest families — \$500,000 minimum discretionary income — intend to increase premium goods and services outlays.
- Within the luxury shopper categories alone — clothing, accessories, jewelry, home décor, etc. — researchers estimate spending will increase by \$26.6 billion, or nearly 8 percent. Researchers estimate an 11 percent increase in luxury travel and a 12 percent increase in luxury automobile purchases, assuming supply.
- The percentage of consumers who expect to reduce their luxury consumption in 2011 has dropped by nearly 50 percent in the past year alone — from 16 percent to 9 percent — and over 300 percent since 2008.

“It is a relief to finally be able to see a significant return of affluent consumers to the luxury marketplace,” says Dr. Jim Taylor, vice-chairman of Harrison Group,

summarizing the good news for luxury marketers, producers and retailers. Still, Taylor notes, even the affluent remain “skittish,” with 70 percent believing that the recession is still on.

It's a sentiment echoed by yet another measure of the affluent mindset. Pam Danziger, founder of the marketing consulting firm Unity Marketing, and author of the new book, *Putting the Luxe Back in Luxury*, says the company's quarterly Luxury Consumer Index, which measures the attitudes of affluents, has come halfway back from where it was during the recession, but it hasn't recovered all the way. “It's still very dicey out there and people are still very concerned. Two-thirds of our luxury consumers surveyed the first week of April said the recession was not over yet.”

NOT BUSINESS AS USUAL

In its white paper, “The New World of Luxury — Caught Between Growing Momentum and Lasting Change,” the Boston Consulting Group notes “the signs of a revival do not augur a return to business as usual” especially for the luxury market. No longer are customers buying luxury on a whim — or paying no attention to price. Ketty Pucci-Sisti Maisonrouge, a member of the faculty at the Columbia School of Business and principal of luxury consulting firm KM&Co, explains, “The rich got a scare in 2008–2009. They weren't sure of anything going forward. One of the most important key consequences of the recession is that all the luxury customers have become more discriminating.” According to Lewis, affluents “will closely assess the value of what they are getting.”

Yet Goldstein remains optimistic that the U.S. economy is fundamentally strong. In his opinion, “It won't be a here-we-go-again regarding the recession. It will be about how much further food and gas prices are going up. The biggest change is that consumers have become more cautious about debt.” Pedraza calls it a “toss-up economy” because the jury is still out as to whether it is sustainable or we are up for a bigger fall.

“What we're seeing coming out of the recession is that a lot of the affluent shoppers' mindsets are very similar to the middle class when it comes to being responsible shoppers,” says Candace Corlett, president of WSL Strategic Retailing. While they are coming out of the recession sooner, with more money to spend, they are shopping with a different attitude. “It's no longer the wanton spending that there was. It's now more responsible, more cautious. They have certain rules that they're going to follow.” And while, she observes, “we have seen a return of the more affluent to the stores where they enjoy shopping, there is an awareness of ‘I'm no fool and, yes, I may be willing to buy a boat or spend

\$2,500 on a handbag, but I'm also going to check prices on paper towels.”

“While luxury shoppers during the recession might have traded down within the luxury channel, shopping within the different tiers, what we've seen is that people have come back to their old ways.” says Dimitri Vermès, vice president of the retail division of CBX, a full-service strategic branding and design agency. “But although affluent shoppers may be anxious to buy, they are buying more timeless or classic pieces.”

QUALITY SELLS

“Is the brand worth it?” That question remains top of mind for affluent customers, according to Maisonrouge. After luxury retailers heavily discounted prices, customers

a discretionary purchase they buy for one season and then get rid of. It's something that can last for season after season.”

Moreover, Maisonrouge points out, diamonds offer consumers both timelessness and a value proposition. “Not only can you wear and enjoy a diamond, but there is also the knowledge that if things go really bad, you can sell it. Diamonds are different than other accessory categories — they make a woman feel beautiful, plus there is the intrinsic understanding that they increase in value.”

A NEW BREED OF CONSUMERS

In its white paper, the Boston Consulting Group labels the recession as “the tipping point for several trends — including profound changes in consumer behavior and

43% OF AMERICANS Feel country is still in recession

became unsure of the real value. Furthermore, she points to the fact that customers now ask themselves “Do I really need it? Is it a necessity?” Goldstein notes that even the rich are not immune to bargains.

Pedraza observes that the wealthy want something that will last for five to 20 years. They are cautious and not being frivolous. Moreover, they are negotiating hard. They feel they have the edge because they can afford to wait.

“Quality will always sell,” advises Maisonrouge. “Companies must go back to their core values and really deliver true quality and true service.”

In terms of diamonds, Pedraza says the demand for jewelry has come back, “but it is the last category to turn up significantly since it is not seen as necessary as apparel.”

But while jewelry is the ultimate luxury, it can fit in with the new affluent consumer's mindset, suggests Danziger. These shoppers are looking for purchases that are ultimately “worth” more to them, in that they will enhance their lives for years to come. “It's a different type of ‘investment thinking,’ in that the product is no longer

the competitive landscape.”

“I don't think we'll ever go back to a mindless more-is-better construct,” says Kate Newlin, retail strategist and author of *Shoppportunity* and *Passion Brands*. The new shopping matrix means finding a balance between low-cost, high-convenience factors. “It's deciding how much time and effort versus money the consumer is willing to invest in the acquisition of an item. Stores do themselves a disservice in assuming that price consideration is the deciding factor for everyone.”

“If there's enough of a recovery, people will loosen up the purse strings,” says David Capece, chief executive officer (CEO) of Sparxoo, a digital media agency based in Tampa, Florida. The truth of the matter is “consumers like to consume. All other things being equal, they prefer to spend than not to spend. Right now, they're still trying to be fiscally responsible but at any sign that things are all clear, there's some pent-up demand and they'll be ready to spend. It's just a matter of waiting for that signal and that signal hasn't come.”



It is with the much-courted precession “aspirational shopper” that you’ll see “the most long-term effect of the recession,” says Corlett. “The reality of managing aspirations and getting in touch with who you are and what you can afford was a rude wake-up call. There’s a lot more awareness about the tradeoff of having to work hard to get what you want.” And there’s a willingness to cut back on spending in some areas to afford spending in others. Making smart choices is now a pervasive mindset, she points out.

There is a notion of responsibility, says Peter Rose, senior vice president at The Futures Company, a trend and futures marketing consultancy, citing a trend seen in the company’s Yankelovich MONITOR, an annual tracking study of American consumers. “Consumers recognized a new era at hand and that if they did not begin to act more responsibly in terms of how they spent, in terms of how they lived their lives in general, in terms of the brands with whom they decided to have a relationship, in terms of paying greater attention to corporate social responsibility, the country was going to continue to be in big trouble.”

This imbedded sense of shopper responsibility for the

consequences of what they are spending wasn’t there precession, says Rose. But taking on debt at exorbitant interest rates and a deal-with-it-later attitude have gone with the recession. “Shoppers don’t want to fall into that trap again. And then there are external factors pushing down on them, so even if they behaved well and paid off their credit card in full, they still may have had their credit limits slashed in the past couple of years. It’s something that has permeated all of society.”

The result of that thinking, Rose says, created an overarching sense of being more mindful of the consequences of the decisions made when consumers shopped and that they could not continue to “overdo.” But rather than a sense of frugality going forward, he says, which at best was “a short-term and necessary coping mechanism,” the new mantra is “prioritization. ‘I’m going to make some really hard decisions about what I can or cannot buy and the things that make the cut for me and my family are based on our situation and our needs rather than based on our wants.’ But that careful evaluation still leaves plenty of opportunity for luxury, as the pros and cons of any purchase are carefully evaluated.” ♦

RETAIL

FIVE LARGEST SHOPPING CENTERS

Mall of America Minneapolis, Minnesota
Woodfield Shopping Center Schaumburg, Illinois
South Coast Plaza Costa Mesa, California
King of Prussia Mall King of Prussia, Pennsylvania
Millcreek Mall Erie, Pennsylvania

Number of Shopping Centers	107,823
Shopping Centers by Type	
Super-Regional (800,000+ sq ft)	646
Regional (400,000 - 800,000 sq ft)	791
Community (100,000 - 350,000 sq ft)	9,324
Neighborhood (30,000 - 150,000 sq ft)	31,887
Power Center (250,000 - 600,000 sq ft)	2,083
Lifestyle (150,000 - 500,000 sq ft)	418
Theme/Festival (80,000 - 250,000 sq ft)	250
Outlet (50,000 - 400,000 sq ft)	325
Strip/Convenience (< 30,000 sq ft)	62,030
Airport Retail (75,000 - 250,000 sq ft)	69

General Merchandise Store Sales

U.S.\$ billions

1999	380.291
2000	404.344
2001	427.586
2002	446.648
2003	468.900
2004	497.506
2005	528.534
2006	554.392
2007	578.728
2008	596.541
2009	592.009

Department Stores

U.S.\$ billions

1999	100.302
2000	100.284
2001	93.871
2002	90.228
2003	88.276
2004	87.265
2005	87.460
2006	82.661
2007	79.105
2008	72.802
2009	64.362

Jewelry Store Sales

U.S.\$ billions

1999	23.857
2000	24.988
2001	23.728
2002	24.816
2003	25.671
2004	27.808
2005	28.609
2006	30.293
2007	31.032
2008	29.348
2009	25.717

Discount Department Stores

U.S.\$ billions

1999	136.545
2000	139.637
2001	141.708
2002	137.545
2003	132.497
2004	134.171
2005	133.232
2006	135.470
2007	134.926
2008	130.113
2009	126.426

SALES

	2008	2009	2010
Total Retail Sales	US\$4.41 tril.	US\$4.09 tril.	US\$4.36 tril.
Year-on-Year % Change in Retail Sales	- 0.9%	- 7.2%	6.4%
Shopping Center Sales	US\$2.27 tril.	US\$2.22 tril.	US\$2.29 tril.
Year-on-Year % Change in Shopping Center Sales	0.7%	- 2.6%	3.4%

EMPLOYMENT

	2008	2009	2010
Total Retail Employees	15.3 mil.	14.5 mil.	14.4 mil.
Total Shopping Center Employees	12.8 mil.	12.2 mil.	12.1 mil.

Photos by REUTERS Andy Clark/Mike Seger
 Source: International Council of Shopping Centers

A NEW ATTITUDE

Upscale ecommerce opportunities and easily accessed mobile platforms wooed shoppers away from brick-and-mortar stores. To bring them back, retailers will need to shift gears.

BY PHYLIS SCHILLER

The usual calculus was always you can go to Walmart and get lots of stuff for less money or you can go to a first-tier retailer and get some stuff for a lot of money,” explains Kate Newlin, retail strategist and author of *Shoppportunity* and *Passion Brands*. “But what’s happened is you don’t have to go anywhere and you can get some pretty good stuff, pretty easily. That sense of “curation,” of having a selection of merchandise edited to be of interest to a particular consumer, is now, to a great extent, being offered by internet sites.”

Today’s shopping channels include a variety of opportunities, points out David Capece, chief executive officer (CEO) of Sparxoo, a digital media agency based in Tampa, Florida. “Sites that are household names, such as Amazon and Zappos, which is owned by Amazon, are doing very well. There are also the flash sale sites that have grown over the past few years — Gilt Groupe, one of the larger ones, and One Kings Lane. It’s a new way of shopping for sure and it’s here to stay.”

One reason the private sales sites have managed to create enough of a luxury cachet to entice the affluent shopper is that “they are members-only sites, and therefore exclusive,” says Dimitri Vermès, vice president of the retail division of CBX, a full-service strategic branding and

design agency based in New York City, citing research from Mintel International, a provider of market intelligence. “The sites also benefit from offering sales for very brief amounts of time, thereby further limiting the number of items sold. The short sale windows also serve to generate a good deal of excitement among members of the sites.”

THE VALUE EQUATION

Online opportunities — sites like Groupon and LivingSocial — have gotten shoppers used to buying



things at discount, continues Capece. “What I think is interesting is where do we go from here? Groupon has performed really, really well offering items that are not true luxuries but more impulse purchases, small luxuries that are part of life’s pleasures. And in many ways, that illuminates where we are in the state of the economy. Consumers want more than the basics, they want their luxuries, and they are often forced to settle for simple luxuries at affordable prices. The good news is that they’re willing to give in to the impulse to purchase those simple luxuries, if they’re affordable enough. If the recovery really takes hold, then those impulse luxury purchases will grow both in number and in price points...but we’re really not there yet. It’s more giving people a taste of luxury without breaking the bank.”

“I think that with the new web-enabled smart phones, shoppers need to be followed rather than led,” says Paco Underhill, CEO of Envirosell and the author of the new book *What Women Want*. “There are a great deal of us out there who are not celebrating how much we can spend on something, but how little we spend on something. And that’s the way shoppers are flaunting their smartness rather than their wealth.”

It’s not about necessarily spending less than anybody else, says Newlin, that makes consumers feel they’ve made the smart choice, “it’s about not wanting to spend more than someone else did, which can make them feel stupid.” And today, Newlin adds, “there is this sense that by offering the right quality and the right price, the web has become a having-your-cake-and-eating-it-too place.”

“I think shopping habits have changed because of the economy,” continues Newlin, “but there’s a concurrent thing going on where technological developments are wooing consumers away from brick-and-mortars. It would have been masked if we were still spending like we were in 2006 and 2007. The effect wouldn’t have been that sharply an either/or but more of an additive. But because shoppers learned to save and stay out of the stores because they don’t trust themselves in them, these other alternatives got in under the radar.”

One area, says Candace Corlett, president of WSL Strategic Retailing, “where the rich are different is their use of the internet. They have learned to shop the web to save money, more so than lower- and middle-income shoppers. It’s a mix of finding a better deal — mostly with higher-ticket items like electronics, computers, a car, vacation — believing that sales are better on the internet than they are in the stores and also learning where to get the best price and to find the product that’s the best value.”

The question of where to find the best values, says Underhill, has consumers deeply puzzled. “With a web-enabled mobile phone, they have access to information and pricing that they never had before.” In terms of jewelry, he says, it has motivated people “to question retailers, ‘why should I buy a diamond from you when I can buy it online for less and have you mount it?’ And that is testament to the confidence that people have in the online purchase; they actually believe in it and feel that sense of confidence in it.”

A CHANGE OF VENUE

Along with that shopping sea change, consumers also discovered that trading down wasn’t necessarily as low a blow as they thought. In fact, according to Peter Rose, senior vice president at The Futures Company, a trend and futures marketing consultancy, about two-thirds of American consumers surveyed in the company’s annual Yankelovich MONITOR tracking study say that aside from prices, shopping at discount stores is no different than shopping in any other department stores. “The figure is 64 percent and it’s pretty consistent across gender and generation and even to some extent across income — it’s 57 percent in households with incomes of \$125,000 or more. If we’d asked that question in the 1970s, there’d be a greater schism between the haves and the have-nots.”

Corlett says that while affluents would buy paper towels in Target, “we don’t see them in dollar stores, which have become huge for middle-income shoppers. The affluent are in warehouse clubs. Costco, in particular, skews very high income. Home Depot and Lowe’s are seen as places to go for things you need while Costco is a destination to go to see what great buys you might find.”

According to Rose, “some consumers at that more affluent level will still want to play it safe and go to a retailer they believe provides them with the greatest likelihood of making the right purchase.” For them, value is going to be that they are making this purchase once and they don’t want it to be a wrong decision.

Economic insecurity means consumers have spent the past few years having to justify to themselves why they should make a purchase, Rose goes on to say. And as a result, they “tend to default more to the tangible attributes and benefits” of a product. But, he says, it doesn’t mean they do so at the expense of the shopping experience. They need to know that the retailer has their back so they can make the right choices. “They will go to Tiffany to have them walk them through the purchase so they can feel safe.” And when it comes to providing that reassuring retail ambience in which to make a

high-ticket purchase, nobody does it better than a luxury brick-and-mortar.

EXPERIENCE COUNTS

“There are certain high-impact moments in your life story,” explains Newlin. “when you want the trust, the advice, the professionalism that is the mark of a great luxury experience. It delivers the full-meal deal.”

“When we talk about the affluent shopping in specialty stores,” says Corlett, “they see the experience as part of the value proposition because it helps them feel smart about their purchase.” The retail experience reinforces their belief that they are making the right choices, getting the best value. It helps them understand the qualities that make a product worth purchasing.

The consumer experience begins from when the customer walks through the door, says Newlin. “You have to earn the consumers’ sense that they will be welcome in the store — it’s not one thing but a series of cues that tell them they will be treated as the remarkable individuals they believe themselves to be. It’s old school ‘customer of one’ retailing.”

The best-case scenario, says Vermès, is the creation of an environment that allows consumers to feel like they are buying more than just on price. “The retailer needs to provide a meaningful interaction with customers and deliver quality over function from smart phone/social media platforms. Some retailers have created QR codes that can be scanned to provide additional information that allows consumers to feel that much more in control and gives them the tools to make an informed decision about the product they are looking to buy, then and there. Allowing them to stay in the store is one of the factors in getting them to buy — the longer you can get them to dwell, the more opportunity you have to sell them something.” He points out “in a recent news release, Mintel International suggested that ‘brands may need to get more creative to lure consumers into stores, offering more than just retail, and be a venue, not just a shop. Service may extend into advice and demonstrations, while exclusivity and environment may also be key aspects to engage consumers with real life, not virtual, shopping experiences.’”

BRICK AND CLICK

Giving people that truly branded in-store experience that goes further than just getting the product is something they can’t get online, agrees Capece. But that doesn’t mean the two worlds are incompatible.

“We did a study on how brands can inform consumers about what they offer — products and services,” continues Capece. “Number one is continually the

website. Even though we’re in an era where mobile is growing most rapidly, websites are still a core place consumers check. Having a website presence is vital for a retailer. A lot of brands also are experimenting with social media and mobile and other initiatives that are more grassroots and gorilla.”

Across the consumer segment, says Capece, shoppers are choosing multiple channels to purchase products. “It’s not just the web or the store. It’s a mixture of that. The consumer is really channel agnostic. They go to the store and look at a product and then go to the web and shop for that product at the best price point but may go back to the store to pick it up rather than pay for shipping. There are multiple channels of interaction and touch points and the brands need to maintain the same customer experience they offer in the store throughout the different channels.”

The lines between real and virtual are blurring, points out Rose, “especially for the younger consumers. The expectation is to be able to access the information wherever and whenever needed but also have the safety and security of being able to see and touch the product in an environment where the retailer has minimized any regrets the consumer might have about the purchase.”

One website that successfully partners with brick-and-mortar retailers, says Capece, is Groupon. “Most of the businesses offering deals on Groupon are local restaurants, local health facilities, gyms. We’ve done some research and we’ve seen that customers are interested in supporting local brands, but they’re being very discerning about where they’re making those purchases.”

If you are that brick-and-mortar company and you’re using all these channels to bring in customers, probably at a discount, then how do you get them hooked and how do you get them to come again? According to Capece, “It goes back to the idea of making it an experience, making it a truly outstanding product/service or providing a place for community, somewhere to socialize with friends. So in that case, it’s taking a basic necessity and elevating it to a simple luxury.”

GETTING THEM IN THE DOOR

“Every quarter we ask the luxury shoppers we survey if they are still making changes based on the current economic times,” says Pam Danziger, founder of the marketing consulting firm Unity Marketing and author of the new book *Putting the Luxe Back in Luxury*. “One of their favorite money-saving strategies is to not go shopping as frequently, which means they are staying out of harm’s way.” This leaves it up to the retailer to find a way to give them reasons to come into the stores. “Sales are popular ways,”

says Danziger, “but there should be other more creative ways to entice them to shop. That should be the goal.”

Sending notices of private sales and special events, keeping in touch with customers is extremely valuable, advises Corlett. “This is a shopper who is now pausing before she buys and weighing whether it’s a smart use of her money. It’s going to take more than a broad-stroke advertising message to convince her to buy more of what she already has. It’s that pushback against ‘Why do I need another fragrance or another bag?’ Personal messaging reinforces why she needs to buy. The private sale satisfies her responsibility to get it at the best price.”

In terms of jewelry, points out Underhill, “if you can’t get them in the door, you can’t show it to them. If you

your game against the competition. Facebook and other social media tools provide social interaction not only for conversations with family members and friends but also with brands. And if you want to get anxious shoppers to purchase a luxury piece, your customer service needs to be there in order to push them over the edge to make that final purchase in store.”

There is a big store to small store comeback that is making its way across channels, says Vermès. “The Walmarts are looking for neighborhood stores; the Targets are looking for a pared-down approach to their offerings. Even brands like Best Buy are testing spaces that may be just showcases for products, where you can’t buy there but you can have the product

TRACKING JEWELRY SHOPPING

ACCORDING TO UNITY MARKETING JEWELRY TRACKING REPORT, FIRST QUARTER 2011 LUXURY TRACKING STUDY:

- Jewelry stores picked up in terms of sales from fourth-quarter 2010. The trend there was positive.
- Overall purchases by affluents of personal luxuries — fashion, fashion accessories, jewelry and watches — did decline in the first quarter.
- The number-one most favored destination for shoppers in the personal luxury category was jewelry stores; they showed a positive uptick from fourth-quarter 2010. Number two was department stores and number three was luxury branded stores like the Burberry, Armani, Gucci, Chanel stores. Fourth was the internet. The fact that internet sales were down for the quarter is unusual — the internet is typically number two or three.

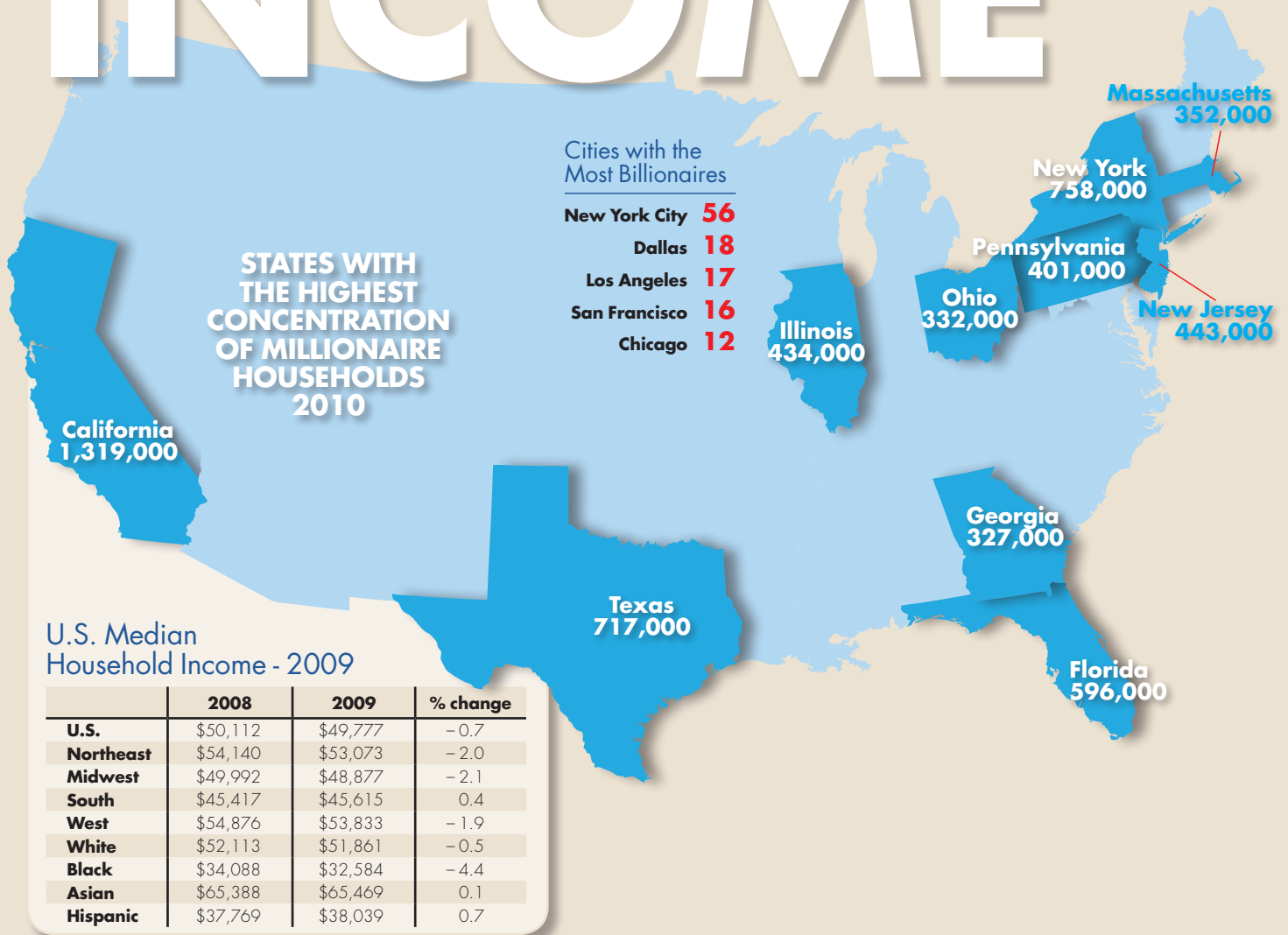
can’t get them to put it on, you can’t sell it. I don’t care how many ads you place and what’s on the internet, if you can’t get them in the door to see, touch and feel and get the romance of it, you’re not going to get the sale.” Ways to get them to come to the store, says Underhill, include event marketing where they can try things on. “It’s also the quality of the sales help, the physical design of the store. Some of it is referral marketing. Some of it is taking some risks and having a bit of an attitude.”

Whether aiming at a luxury shopper or a bargain hunter, says Vermès, what is important is to deliver a consistent customer experience. And it’s even more important today because of the different channels of purchase. How you integrate social media will be the game changer for your brand and allow you to step up

delivered or purchased through the web.” He points to Saks Fifth Avenue OFF 5TH and their luxury-in-a-loft environment. “Their presentation of jewelry has been turned up a notch — lighting has been more focused and brought down to the jewelry case in order to bring customers closer to the product. They are selling much more of that product now than ever before by presenting it in a new environment with better lighting and better customer service.”

Everybody wants what Apple has put out there, sums up Vermès. “But it’s not just the pared-down approach and simple design. It’s the approachable customer experience. What’s important is for each retailer to deliver its own unique customer experience and put their brand DNA at the forefront.” ♦

INCOME



Household Income 2000 - 2009

	Percentage Distribution									
	Total	Under \$15,000	\$15,000 to \$24,999	\$25,000 to \$34,999	\$35,000 to \$49,999	\$50,000 to \$74,999	\$75,000 to \$99,999	\$100,000 to \$149,999	\$150,000 to \$199,999	\$200,000 and over
2009	100.0	13.0	11.9	11.1	14.1	18.1	11.5	11.9	4.4	3.8
2008	100.0	13.4	12.0	11.0	14.1	17.6	11.9	11.9	4.3	3.7
2007	100.0	12.9	11.3	10.5	14.0	18.0	12.0	12.7	4.7	4.0
2006	100.0	12.6	11.2	11.1	14.1	18.2	11.6	12.5	4.7	4.0
2005	100.0	13.0	11.5	10.8	14.2	18.1	12.1	12.0	4.3	4.0
2004	100.0	13.3	11.6	11.0	14.1	18.1	12.0	11.9	4.4	3.6
2003	100.0	13.2	11.6	10.9	14.0	17.7	12.2	12.3	4.4	3.7
2002	100.0	12.9	11.4	10.6	14.5	18.0	12.5	12.3	4.2	3.7
2001	100.0	12.4	11.4	10.5	14.8	17.9	12.6	12.2	4.3	3.9
2000	100.0	12.1	11.1	10.5	14.5	18.4	12.7	12.3	4.5	3.8

Median Earnings of Full-Time, Year-Round Workers by Sex 2005 - 2009		MALE		FEMALE	
		Workers With Earnings (millions)	Median Earnings	Workers With Earnings (millions)	Median Earnings
2009	81.9	\$36,331	72.9	\$26,030	
2008	84.0	\$36,331	74.5	\$25,553	
2007	84.4	\$37,898	74.2	\$26,770	
2006	83.9	\$38,169	73.6	\$26,028	
2005	82.9	\$37,740	72.4	\$25,352	



ENGAGING GEN Y

The good news about Gen Y is that they are getting married, just a bit later, and with expectations for a bigger diamond.

By PHYLLIS SCHILLER

Although Generation Y, or the Millennials, as they are also called, is a demographic that covers those born between 1977 and 2002, the individuals most marketers covet are those born between 1978 and 1989, the 22- to 33-year-olds, says Ellen Fruchtmann, Fruchtmann Marketing, a full-service marketing firm specializing in the jewelry industry that is based in Toledo, Ohio.

And while GenYs have been hit hard by the recession, starting their careers in a shrinking job market, many see the economic downturn “as a temporary roadblock and not a permanent change in the way they anticipated spending money,” says Kit Yarrow, consumer psychologist, professor at Golden Gate University and co-author of

Gen BuY: How Tweens, Teens, and Twenty-Somethings are Revolutionizing Retail. “This is different from older generations, who really did change a lot of their desires and views on impulsive spending. What I have heard from GenY is, ‘Right now I can’t, but when the recession is over...’ or ‘When I have money...’ or ‘When I can move out of my parents’ house...’ and so on. They haven’t necessarily changed their view on spending, which has always been fairly exuberant, it’s more that they don’t have the means. And when they do have the means, they intend to spend.”

A lot of this, continues Yarrow, has to do with their great confidence in themselves. They expect that “whatever they need, they will make enough money to get it. If they

get the money, if they get those jobs, they'll definitely be willing to spend on luxury items."

And while, by necessity, they are being frugal right now, points out Bea Fields, president of Bea Fields Companies, a leadership consultancy for high-growth companies, and co-author of *Millennial Leaders: Success Stories From Today's Most Brilliant Generation Y Leaders*, "They are still spending or investing in anything related to the technology they need in order to stay connected. Their lifeline to the world is through Facebook or cell phones or texting. So they're finding a way to save their money in order to buy the iPads and the cell phones."

THE MILLENNIAL MINDSET

Like most shoppers, what the new economy has taught Gen Y, says Fruchtman, is to be discerning about with whom and where they spend their money. "If they want a luxury product, chances are they are going to have to cut back somewhere else. So it better be great, they better love it. And the experience better be second to none." And they are interested in luxury purchases. They are the new aspirational shoppers, she says.

And just like the rest of today's consumers, says Kate Peterson, president of Performance Concepts, a retail consulting firm based in the Washington, D.C., area, "The Gen Y customer has become far more value conscious and far more demanding when it comes to value expectations. Remember, though, that 'value' is highly personal." So, she points out, whatever they are told about an item needs to relate to them as individuals. "They are still spending money — in significant average ticket quantities — but retailers have to work a lot harder to earn it. For the Gen Y customer, in particular, it's not about what they spend; it's about what they get for what they spend."

They like fresh ideas, points out Fruchtman. "They are looking for not only the new but something that can be uniquely theirs." Moreover, says Yarrow, "they want something that other people will notice, that makes a statement about who they are, which is personalized for them. They want to have a say in how it looks, how it was created. I really think that they are going to be willing to spend money to get what they want, but they are going to pursue all avenues to get it, including online merchants, and any way they think they can get it cheaper or exclusive to them."

IS THERE A DIAMOND IN THEIR FUTURE?

Much has been made of the Gen Y shopper and their marriage mindset. But as the recent royal wedding proved, they are marrying — just on their own timetable. "I wouldn't be concerned," says Yarrow. "I think it's just

a temporary burp while they demographically catch up to the marrying age, which is now getting closer to 30 than 20." In fact, she says, "Gen Y does say that they want to get married; it's just that they do it much later. And this is kind of good news for the diamond industry: When they do get engaged, they'll have more money, because they'll be older. And when they choose an engagement ring, they're going to want it to be something that they would feel proud to wear. They definitely expect larger stones. In my generation, if you got up to a carat, it was 'wow,' but that size stone is the starting point for these kids."

Fields points out that Gen Y couples believe in living together to see if it's going to work. It's partly for financial reasons and also because they have seen their parents go through several divorces and they don't want to go down that road. "Prince William and Kate's wedding proved this is global — staying together longer and waiting to get married. They don't want to jump into a relationship if they think it will fizzle out in a few years."

And because they're living together and have a shared life already, says Yarrow, "it's much more of a mutual decision than 'popping the question.' It's something that they've talked about and planned for, including planning the ring together."

The upper end of Generation Y, says Peterson, is prime bridal age right now — 27.5 for the bride, 29.5 for the groom. They are very much interested in diamond engagement/wedding rings, and are very much focused on styling and design. And contrary to their preferences in other luxury areas, brand name is far less significant in bridal jewelry. It's all about the styling, and about their ability to customize and to make it their own. With the age of the first-time bridal couple so much higher these days, it's a safe bet that they are buying fashion jewelry long before bridal jewelry, which is a stark contrast to what most of us have learned over the years about the engagement ring being the first real jewelry purchase. They are earning — and spending — more money earlier and buying wedding jewelry later, so their experience with buying fashion jewelry/gifts most often determines their first choice when it comes to bridal purchases. We tell retailers that if you don't have their loyalty for those earlier purchases, you may not even get a shot at the engagement ring."

This age demographic is also saddled with college loans, car loans and is looking to spend their hard-earned dollars on their first condo or home, says Fruchtman. "They are definitely materialistic. They have expensive taste. It's just taking them longer to reach that age of truly disposable income."

Personalization is huge with them, Yarrow says, especially with something like a diamond engagement ring that they're going to wear for a long time. "It's really primary that they have a sense that they have something to do with the design. That is a great source of pride — not just having the ring but that they expressed themselves through the ring is major with this group."

HOW TO REACH THEM

"Want to tap into this buyer? Get online in a big way. Hire young sales associates who are personable and educated. Make sure that your store has some 'cool' factors," recommends Fruchtman.

"If I were a jeweler," says Fields, "I'd get myself well planted on Facebook and Twitter. For Gen Y, communicating through Facebook and Twitter is second nature. If you can get them to connect with you that way, the likelihood of getting them into your store is much, much greater. If you set up a Facebook fan page that's like a jewelry boutique and have fun interaction with customers, the price factor goes away. Ask quizzes, create contests, engage them in fun conversation about jewelry but don't 'sell them.' If it's all about 'buy this,'

They're so comfortable in the online medium, cautions Peterson, "the stores that don't have a presence online — a high-powered, highly interactive, 2-clicks-max to navigate website — or a way to reach this generation in their medium, will have difficulty." You need to get out there, she advises, "using social media to become a place where this generation can get educated about buying diamonds, feel like they have more of a stake belonging to that club. Then, I think the future looks kind of bright."

Gen Y loves sources of information, says Yarrow, "which is why I think the QR codes in stores have an enormous future. If they're looking at something and they can flash the QR code and find out more about the product or download a video, they love that. And they'll check other retailers while they're in a store, go on their phone while they're shopping for a diamond and check to see what the price would be on Blue Nile."

They're looking for transparency, says Fruchtman. "You have to deliver on your brand promise. Spend hundreds of thousands of dollars in your marketing and if it's not what they expected when they walk inside, they will never give you a second chance. They're looking for sales associates they can relate to. They're looking for the

27.5: BRIDE 29.5: GROOM

Average Marriage Age

'we have that sale,' you'll lose them. You need to build a fan base by engaging with them, which is what Gen Y likes to do. They want to interact and get involved and get to know you as people and not as a thing." Fields also suggests hiring a Gen Y to help set up the fan page and "create a really young presence on the internet. Gen Ys are attracted to other Gen Ys. If they see a lot of young faces on a fan page, they will be more inclined to go there."

Sometimes, says Yarrow, a sense of urgency is what it takes to get Gen Y to pull the trigger and buy. This could be a design event or a special limited-time selection of diamonds. And reviewer websites like Yelp are another way to reach them, she says. "They are hugely influential with this generation. They'll go on Yelp and read reviews of stores where other young brides have chosen their rings and they will buy jewelry based on Yelp reviews. People think it's just for lawn care and such, but it's for the very highest-ticket items as well. That endorsement by another Gen Y, someone they relate to, carries more weight for them than what some industry expert has to say. If you are a brick-and-mortar and you can get some good Yelp reviews, it will be very influential."

'experience.' But, most of all, they are looking to connect with each other and they do that with everything from blogs to online chats. They read reviews and they look for feedback from others just like them."

According to Peterson, "Statistics indicate that well over 90 percent of these consumers research online — up to six months in advance of a diamond purchase. We also know that while some may buy online, most still prefer the experience of buying face to face. They are looking for efficiency, quality, service and value. This is the 'Trophy Kids' generation — the group that was raised on 'self esteem' and 'self appreciation.' They care about how it relates to them, personally."

For this digitally dependent demographic, suggests Yarrow, the brick-and-mortar stores become "showrooms" that they use to see merchandise and they then go and buy on the web what they saw in the store. "To tempt them to make the purchase in store, the brick-and-mortar retailer needs to offer them the sense of value they feel they are getting online. That's how you can reach them. Make them feel you are offering them something extra, give them the sense buying there makes them part of an exclusive club." ♦

BUDGET RETAILERS FLOUNDER

Early 2011 has not been kind to mass merchant retailers. | BY RICCI DIPSHAN

Despite growing national retail sales and a rise in the consumer sentiment index, sales for the first 13 weeks of 2011 have been tepid for mass merchant discount retailers, chain and department stores that offer a wide variety of merchandise at lower price points.

Retail sales for the first four months of 2011 were 8.1 percent higher than the same period in 2010, with general merchandise sales increasing 2.7 percent, according to the U.S. Commerce Department. Consumer confidence, according to the Thomson Reuters/University of Michigan consumer sentiment index, was at 72.4 in May, increasing from April's 69.8 but only slightly better than the 72.2 reported in April 2010.

Yet these positive economic figures have not translated into increased sales for mass market merchants around the nation. Walmart's first-quarter U.S. sales remained flat, increasing a sluggish .6 percent year on year, with comparable store sales dropping 1.1 percent. JCPenney's sales were similarly flat, only .4 percent higher than the first quarter of 2010. Kohl's did better, reporting a 3.1 percent increase in sales for first-quarter 2011 compared to the previous year. Sears was actually in decline for the quarter, with domestics sales from Sears division stores shrinking by 5.2 percent, and sales from Kmart division stores decreasing 1.6 percent year on year.

Mass merchants' luxury competitors fared better for the quarter. Saks Fifth Avenue, for example, reported a first-quarter total sales increase of 8.8 percent, while Nordstrom posted a 12 percent total sales increase for the same period. The luxury retailers' growth was in line with a report by MasterCard Advisors SpendingPulse that luxury spending rose in April 2011 by 9.6 percent year on year, its seventh consecutive month of growth.

Given the inflation in the commodity markets and the rising cost of food and fuel, mass merchant retailers' trouble jump-starting their sales is not wholly unexpected. Food prices have risen by 3.2 percent for the 12 months that ended in April 2011, with more than three-fourths of that — 2.3 percent — taking place during 2011. Gasoline prices have also risen by 33.1 percent over the same 12 months, almost half of which came in 2011.

Retail sales have been further tempered by the unusually steep rise in the price of jewelry, making retailers' jewelry items less of an affordable contributor to total sales and more of a costly luxury. The U.S. Consumer Price Index (CPI) for jewelry rose 8.5 percent in April 2011 to 165.581. Meanwhile, the CPI for all product categories rose 3.2 percent year on year in April to 224.906.

Most detrimental to the public's inclination to spend and buy, however, may be the price of gasoline. "There is no question that fuel prices are slowing down sales," observes Greg Buzek, president of the Tennessee-based global research and advisory firm IHL Group. "Every sustained penny increase in fuel prices takes \$1.7 billion out of consumers' wallets. About \$65 billion has been shifted away from other purchases to fuel costs since the beginning of the year; and the Target and Walmart shoppers are the most affected by fuel prices."

A Gallup poll reported that more than half of Americans — 55 percent — surveyed in April still believe the country is in a recession or depression, with 16 percent saying the economy is slowing down, despite positive gross domestic product (GDP) growth since the third quarter of 2009.

"The recession is still affecting an awful lot of consumers," says Jim Dion, president of Dionco, a Chicago-based retail consulting and training firm, adding that "In many parts of the country, the weather has just been really awful," which also has kept consumers out of stores.

To offset the problem of less store traffic, some retailers are putting more stock in ecommerce, which, according to Dion, "has been the strongest part of retail for the past two to three years, and has continued double-digit sales increases." Walmart, for example, recently acquired the social media company Kosmix, while Kohl's bought its third ecommerce fulfillment center, which it plans to have operational before the 2011 holiday season.

Despite their intensified ecommerce efforts, mass merchant retailers may have to wait out inflated commodity prices and wary consumers to see their sales numbers start to match those of luxury stores. "Inventories are pretty much in place so retailers don't need to panic," reasoned Dion. "And if retailers hold the course and don't discount any more than they have already, they might make some money. But it's going to continue to be a struggle for retailers for the rest of this year." ♦



U.S. SHOWS SLOWED GROWTH ON ENORMOUS BASE

The biggest change in recent years is that while the U.S. is still a big force in terms of ultimate diamond consumption — we estimate U.S. retail still represents 39 percent to 40 percent of the global retail market — and it is still way bigger than other markets, it is lower than what it used to be,” says Humphrey Valenbreder, regional head of ABN AMRO’s International Diamond and Jewelry Group for the Americas and Canada.

“Five years ago, the U.S. was the pacesetter in the worldwide diamond industry, the market leader in polished sales and in pricing. That led to huge import demand,” Valenbreder continues. “But that has changed. Currently, the price setters for polished and the leading targets for sales are China and India. Their actual numbers are smaller than the U.S. but they are the leaders in terms of setting the pace, the trends and the prices of the market.”

At Bank Leumi USA, David Selove, first vice president and deputy group head, says “The U.S. market is responding to several stimuli, both long term and relatively recent, and those stimuli are likely to continue and to underpin future activities. First on the list is the market consolidation that derives from De Beers Supplier of Choice (SOC) initiative. It has divided the manufacturers and wholesalers into clear leaders and followers — and it is to be expected that banking is playing ‘follow the leader.’”

Selove says a second market force that is redrawing the industry landscape and that “will continue to drive prices and the allocation of goods within the global industry is the ascent of India and China in terms of, most fundamentally, demand but also in terms of their effect on worldwide diamond production and trade.”

Despite the realignment of market players, Des Kilalea, director for the Royal Bank of Canada (RBC) Capital Markets in the London equity research division, says “The U.S. will remain a bedrock of final polished diamond sales for many years, maybe for decades to come.

All the talk about growth in China and India overlooks the fact that the U.S. remains by far the single dominant player by volume in the global industry.

BY KAROLYN SCHUSTER

People in awe of China’s growth forget that the U.S. economy will recover and that it will remain the single most important diamond market in terms of dollar volume for the foreseeable future. The U.S. will be in first or second place for the long term; in time, there is no reason to believe China won’t overtake it. China and India combined now total two-thirds of the U.S. market. In ten years, together they will be more than the U.S. market.”

GROWTH CURVE

The industry’s recovery from the global economic recession began in 2010 (see charts on page 85) and has continued through the first quarter of 2011. First-quarter polished diamond imports rose 26 percent to \$5.16 billion and polished exports surged 40 percent to \$4.33 billion. But those increases — impressive and welcome as they are — still haven’t returned the U.S. market to its precrisis levels.

Valenbreder cautions that such a huge, established market as the U.S. can’t expect to achieve the double-digit growth being recorded in new, emerging markets.

“The U.S. is no longer on the steep, sharp slope of growth,” acknowledges Kilalea, “and we’re not going to see annual growth rates of 20 percent again. But we will see growth of 3, 4, 5 percent. There are pockets in the U.S. market where growth will be greater and that growth probably will start with the cheaper goods.”

While noting that “the bottom line for the foreseeable future is that the U.S. will continue to consume an enormous value in diamonds,” Valenbreder admits that there has been a contraction of the industry in the U.S., with fewer players, fewer retail outlets, increased diamond prices and more competition from other luxury categories, such as fashion and technology, which includes the iPhone and mobile phones.

Jewelry stores closed their doors and their businesses in the U.S. in the midst and aftermath of the economic recession. “There is a lower number of retail outlets where diamonds are sold compared to the stellar increase in retail outlets in China and India,” says Valenbreder. “More stores stimulate demand because the diamonds are ‘in their faces.’ And the China and Indian trade is growing to supply those new outlets with inventory. The consolidation of retail outlets in the U.S. is a complete reversal of retail trends in China and India.”

As a direct result of trade reduction caused by the recession, Selove says, “the U.S. has become a trading hub, not only for the temporary arbitrage in polished goods between diamond centers, but also as a function of no longer being the end of the downstream distribution chain for mounted diamond jewelry. The Far East, with its burgeoning middle class, traditional trading terms and lower manufacturing costs, will continue to displace diamond flows away from the U.S. At the same time, the U.S. remains overpopulated with diamond distributors and retailers, particularly mom-and-pop stores and smaller distributors.”

Selove concludes that “The essential forces driving U.S. demand revolve around the willingness of importers and retailers to pay higher prices, particularly in the face of the entrenched U.S. legacy of discounting, memo goods and price-point-sensitive product.”

ENTRENCHED DIAMOND CULTURE

A significant reason for optimism in assessing the U.S. diamond market is its domestic diamond culture. Kilalea says “People forget that the U.S. is a marketplace where diamond buying is firmly entrenched and where the buying of a diamond engagement ring is firmly entrenched. In China, maybe one in four consumers gets a diamond engagement ring in some cities, mostly in the major population centers. The percentage is much higher in the U.S.”

In the U.S., where a diamond engagement ring is almost a must-have, says Valenbreder, “diamonds don’t have to compete with other products. In China, a retailer might try to convince a customer to consider different stones to symbolize love and commitment, maybe opal and jade. But there is no alternative to the diamond in the U.S. culture.”

At the same time, because China is so large, you don’t need much of a market penetration to get significant sales volume. “I was looking at a De Beers chart from a study they did two or three years ago,” says Kilalea. “It showed that in Shanghai, one in ten was getting a diamond engagement ring in 1997 and that grew to six in ten by 2006. In Beijing and Guangzhou, the number rose from 0 in 1997 to 40 percent in 2006. These are very, very big cities and the sales they represent are pretty impressive.”

The well-established position of diamonds in the life cycle of the U.S. consumer means that while diamonds will always be sold, other factors can affect their dollar value. While the amount of disposable, discretionary income is increasing among the middle-class in China and India, it remains stagnant in the U.S. as the recovery takes its time taking hold.

“Price points have a limited elasticity,” says Valenbreder. “The fact that diamonds are becoming more expensive cannot shift price points upward. Staying within price

U.S. Polished Exports - 2000 to 2010

All value in U.S. \$ millions

2000	\$3,845	-
2001	\$3,896	▲ 1.33%
2002	\$4,400	▲ 12.94%
2003	\$5,008	▲ 13.82%
2004	\$6,598	▲ 31.75%
2005	\$8,089	▲ 22.60%
2006	\$9,097	▲ 12.46%
2007	\$11,313	▲ 24.36%
2008	\$14,301	▲ 26.41%
2009	\$9,705	▼ 32.14%
2010	\$14,083	▲ 45.11%

U.S. Polished Imports - 2000 to 2010

All value in U.S. \$ millions

2000	\$11,235	-
2001	\$10,035	▼ 10.68%
2002	\$11,500	▲ 14.60%
2003	\$12,160	▲ 5.74%
2004	\$13,871	▲ 14.07%
2005	\$15,375	▲ 10.84%
2006	\$16,451	▲ 7.00%
2007	\$18,106	▲ 10.06%
2008	\$18,999	▲ 4.93%
2009	\$12,455	▼ 34.44%
2010	\$18,260	▲ 46.61%

points means offering smaller jewelry, smaller stones or replacing gold with silver. The rule of thumb is a guy spends one-quarter to one-third of his annual disposable income on a diamond. Well, if his income hasn't gone up for the past few years but the price of diamonds has, he will be investing the same amount and getting a smaller stone."

MANUFACTURING MOVED

Another factor influencing the market shift to the East is the shift in manufacturing out of the U.S. to the East. The combination of new, more sophisticated manufacturing technology with the inexpensive labor available to overseas firms gave foreign countries a competitive edge in manufacturing costs. Valenbreder says that is "especially true for smaller diamonds. Labor costs are relatively more important with smaller diamonds. In 10-point diamonds, there is a big difference if the work is done by a salaried Indian worker versus a U.S. guild member."

Valenbreder notes that there will "never be a 100 percent shift in manufacturing. Labor is a relatively smaller cost component for larger diamonds. With larger dia-

Kilalea points to tourists as another market segment with strength. "People come to the U.S. to buy diamond jewelry. Tourists come to New York and they go to the Harry Winston store to buy diamonds, just like they go to Rodeo Drive to buy luxury goods. If you asked Harry Winston who buys their diamonds, I think you would be surprised at how many of its customers are wealthy tourists. Tourists buying at Harry Winston are newly rich people but also established rich people. They buy because of the brand, because the Harry Winston name is a statement of quality."

As evidence of the importance of the tourist dollar, Kilalea recalled "the story a few years ago about the Harry Winston store in Paris that sold four pieces of jewelry to a single Russian buyer and those four pieces represented one-third of that store's annual sales."

Referring to the maturation of Gen X and its potential as a jewelry market, Selove notes that "The U.S., as well as the entire Western world, is in the midst of a significant generational and geopolitical wealth transfer. I would expect that as wealth and disposable income strengthen — post recession — so will purchases. But marketing to

\$5.16 BILLION

First-Quarter 2011 U.S. Polished Imports

monds, it will always be important to import, cut and set the diamond in the U.S." because of the proximity to the U.S. customer and because of the skills required.

Kilalea says the migration of processing makes the U.S. a lesser player in manufacturing and "more of a retail, final market for diamonds. If you look at the cost of cutting a carat, in India, it's \$10 to \$50; in China and Thailand, maybe \$15 to \$50; in Belgium and South Africa, the cost goes up to \$50 to \$75. In the U.S., it's probably closer to \$75. For manufacturers, because of the labor cost, only large or special stones are being cut in the big, expensive cutting centers."

OPPORTUNITIES IN A MATURE MARKET

"The fact is that there are immature market segments within the overall mature U.S. market," advises Kilalea. "The demographics of the U.S. are not homogeneous. There's a diversity of race and nationality and immigrant groups. We will see people buying more diamonds. De Beers used to talk about diamond addiction. I haven't heard that phrase lately but it is true that consumers who already have diamond jewelry tend to buy more."

Gen X and other, perhaps more 'reluctant' jewelry purchasing populations, will require effort and ingenuity."

THE ECONOMY SHALL LEAD

The recovery of the U.S. economy — and the speed and strength of that recovery — are considered critical in propelling the diamond industry forward. If people feel secure in their jobs, they are more likely to spend. If retail sales increase, profitability rises and credit restrictions loosen. If productivity increases, wages should follow and the amount of disposable income — from which luxury items like diamonds are purchased — will rise.

"The U.S. is an enormous market but it is a mature market and we should expect the kind of growth that goes with a mature market," advises Valenbreder. "You can't have the same expectations as you have for an emerging market. You've got to manage your expectations. Don't let it frustrate you. There's nothing wrong with smaller single-digit growth — as long as it is growth and there is a big, absolute number and value associated with it." ♦

U.S. WHOLESALER: A NEW WORLD ORDER

U.S. wholesalers' historical role of setting the global diamond market trends has been taken over by foreign competitors.

By KAROLYN SCHUSTER

The entire world was battered by the global economic crisis but for some countries, recovery has been faster and easier. The U.S. is not one of them. For the U.S., recovery is coming in fits and starts, with unemployment, credit availability and consumer confidence still troublesome. The diamond sector — and its customers — are coming back more slowly than in other parts of the world.

“The last quarter of 2008 was horrendous, 2009 reflected the economic meltdown, 2010 had nowhere to go but up,” says Ronald J. Friedman of William Friedman Diamonds in New York City and president of the Diamond Manufacturers and Importers Association of America (DMIA). “India and China did not have the dramatic drops the U.S. did. The problem is our declines were so large that the increases we’re seeing now have not gotten us back to where we were. Even if we continue to see growth, it will come off years of weakness.”

The disparity between the exuberant international diamond market and the contracted domestic market is unprecedented. “The U.S. market is very slow, slower than in the past. There is a lack of money and a lack of confidence,” says Moises Mareyna Rosenberg of M&M Diamonds in Houston, Texas. “Companies with overseas offices are doing well. Prices are high beyond belief — but they’re finding buyers. Companies with U.S. markets only are not doing as well. They’re in survival mode. You know, the U.S. market saved the diamond industry for so many years. Not anymore. Now it’s ‘thanks China, thanks India.’”

Noting that his company’s market is predominantly overseas, Saul Goldberg of William Goldberg adds, “We

are based in New York City. This is where we started. But I don’t think we’re ever going to see our business return here. Internationally, people have a lot of money. They don’t believe in money because money doesn’t do much for them. They believe in diamonds and jewelry.”

Nilesh Sheth of Nice Diamonds in New York City notes that the U.S. dollar sales volume may be similar to five years ago (see charts on page 85) but some of that is due to price inflation, which also means the number of pieces sold probably is lower. While Sheth believes the domestic diamond industry is stable and on the path to recovery, “Local economies in China and India are much more vibrant due to their population size. In addition, local consumption overseas has increased due to higher wages, which means more disposable income, and a growing middle and upper class.”

UNDERSUPPLY OR SPECULATION?

The economic collapse is not the only factor that changed U.S. wholesalers’ business model. Greg Telonis of Mr. Baguette in New York City says De Beers 2003 Supplier of Choice (SOC) initiative “drastically altered the U.S. market for every wholesaler in America. The market shrunk immediately because the number of sightholders was reduced, making it difficult for every wholesaler. A middle wholesaler like myself struggled to get supplies in every category. De Beers tried to create an oligarchy where it could control prices easier with fewer suppliers. It took them a few years, but they accomplished it.”

Telonis says the lack of supply, along with the

consolidation of supply in fewer hands, was a contributing factor in bankruptcies and closings among U.S. wholesalers in recent years. “Okay, some of them mis-managed their businesses, some of them overextended themselves, but one of the main problems was that their supply lines were choked off.”

Supply shortages also were aggravated by the mining companies’ reaction to the economic crisis. “What mining companies are pulling out of the ground is dramatically less,” says Friedman. “When the crisis hit, they knew if they continued to supply the same number of carats, there would be an oversupply that would result in a larger price drop. Better to leave the diamonds in the ground.”

Continually rising diamond prices haven’t helped supply, either. “There was a question for mining companies as to why they should pull it out of the ground now when they can get a higher price for it down the road,” says Friedman. “Manufacturers and traders and dealers — although we’re selling — we’re not under great pressure

to sell because there’s a feeling prices will be higher the next day and the next. Right now, I am not concerned as much about sales; my focus is on my purchases. Buying today is much more difficult than selling.”

Friedman admits that at one point, he thought the supply shortages were caused by speculation but he is now convinced that it’s an issue of undersupply. “Indian manufacturers were bidding up the price of rough and their banks were encouraging them to buy more. There was a lot of money in the hands of people who wanted to spend. I was in Belgium recently and informed by another DMIA member that melee prices were berserk — 50 percent or 100 percent more than just three months ago — and you still can’t find goods.”

“There was a time when every wholesaler had a 10-carat and a 7-carat and a 5-carat. Today, you don’t see that,” says Rosenberg. “I’m not a Walmart anymore. I don’t have everything. I have what I have. What I get I get from auctions, from estates or on the street. There was a time when

U.S. Diamond Exports By Country: 2010

U.S. \$ Thousands
Percent Change 2009 – 2010

Israel	\$4,471,093	▲ 38.5%
India	\$2,727,498	▲ 88.7%
Hong Kong	\$2,269,227	▲ 44.8%
Belgium	\$2,007,474	▲ 58.3%
Switzerland	\$741,973	▲ 16.3%
United Kingdom	\$329,665	▲ 24.7%
Netherlands	\$312,770	▼ 30.5%
United Arab Emirates	\$256,048	▲ 4.6%
Canada	\$233,488	▲ 17.6%
France	\$172,140	▲ 156.6%
Mexico	\$86,032	▲ 5.2%
Netherlands Antilles	\$76,488	▲ 36.0%
China	\$53,345	▲ 29.9%
South Africa	\$51,654	▼ 9.8%
Australia	\$51,587	▲ 28.6%
Subtotal (top 15 countries for exports)	\$13,840,484	▲ 43.4%
Total (all exports)	\$14,137,729	▲ 41.5%

Source: Compiled from tariff and trade data from the U.S. Commerce Department and the U.S. International Trade Commission.

U.S. Diamond Imports By Country: 2010

U.S. \$ Thousands
Percent Change 2009 – 2010

Israel	\$7,740,444	▲ 39.2%
India	\$5,170,694	▲ 67.9%
Belgium	\$3,000,821	▲ 32.4%
South Africa	\$1,132,036	▲ 71.8%
Switzerland	\$391,873	▲ 62.6%
Botswana	\$155,178	▲ 30.7%
Canada	\$135,509	▲ 37.2%
Angola	\$132,107	▲ 172.5%
Hong Kong	\$130,657	▲ 33.4%
Russia	\$107,789	▼ 24.9%
China	\$81,732	▲ 60.9%
United Arab Emirates	\$60,695	▼ 38.5%
United Kingdom	\$54,178	▲ 7.8%
Namibia	\$51,719	▲ 24.0%
Australia	\$41,657	▲ 37.1%
Subtotal (top 15 countries for exports)	\$18,387,089	▲ 46.1%
Total (all exports)	\$18,627,571	▲ 46.0%

Source: Compiled from tariff and trade data from the U.S. Commerce Department and the U.S. International Trade Commission.

a client would come to me with an order for an entire set of stones for a necklace — diamonds from 2 carats to 20 carats, all pear shapes, all D flawless. I would say ‘give me ten days to two weeks and I will set it up.’ Today, it’s not reasonable — or profitable — for me to put that order together. There just aren’t any very, very fine stones around anymore — or maybe they are around, but I can’t get ahold of them.”

CUT TO THE CORE

“The diamond market is not in recession,” says Telonis. “In fact, the market overall is stable in terms of growth. Diamonds are selling. What has changed is how diamonds are sold and the margins. The internet has had a big impact and it has hurt retailers. Retailers are forced to lower their margins on goods — especially on the diamond center stone — if they want to close the sale because those buyers are the most discerning customers. They come in to the retailer armed with paperwork. They do their research on the internet.”

Ronnie VanderLinden of Diamex in New York City says that “Right now, the U.S. market is stronger than the retail market. Most U.S. consumers, outside bridal, are not pushing the button to upgrade or buy those diamond earrings, necklaces or pendants as they did prior to the crash of 2008. When they become more comfortable with the economy and their own personal finances, they will start buying again.

“At the same time, we are seeing more recycled diamonds,” VanderLinden says. He is referring to diamonds that come back into the market from consumers who, seeing the high price being paid for diamonds and precious metals and jewelry itself, are pulling old pieces out of their personal collections and selling them. Friedman says he is seeing “on an isolated basis, very wealthy Americans who want to buy high-end diamonds. Over time, they feel those diamonds will be worth more. We did not see that a number of years ago.”

The current prices for diamonds are helping the resale/recycle market. “I’m thinking of trying to buy back diamonds from clients who bought from us 20 years ago,” says Goldberg. “They have the jewelry in their vaults; no one is wearing it. They could get a really high price for what they are holding but I’m not sure they want to sell. Sometimes it’s sentimental; they want to pass it on. Sometimes they just feel good holding on to it. And there’s another question today. If they sold it, what would they buy with their profits?”

YOUR COMPANY AND YOUR JOB

While India and China are gaining customers and adding retailers in the diamond sector, the U.S. market has been shrinking. In response, some wholesalers left the

industry, others simply took a sabbatical for the duration of the downturn and many more downsized. Amidst all the changes are concerns that businesses that have been passed down through the same family for generations — as many in the diamond industry have — might find their next generation choosing other lines of work.

Telonis says Mr. Baguette went from “22 employees down to five. We used to have traveling salespeople all over the country representing our jewelry line. We don’t have that anymore. It’s hard to make money with a sales force when you’re paying their travel expenses. We do only custom work now. We’ve come full circle from when my father founded the business in 1959. We’ve gone from being a big company with several divisions to a bare-bones diamond dealer. I think the same is true of other wholesalers.”

With no sales force, Telonis is more willing to do consignment programs in which he chooses 10 to 20 retailers and places \$25,000, \$50,000 or \$100,000 of inventory with each of them. “Better to have it in their stores with a chance of a buyer picking it up than locked up in my vault,” he explains.

In his New York City building, VanderLinden recently expanded the number of benches devoted to diamond polishing from 18 to 22, all of them subcontractors. Some of it is in response to the boom in recycled diamonds. But there’s also something bigger at work in his efforts. “We need to get back to manufacturing in this country,” he says. “If ever manufacturing was important, it is today. As a country, we need to start working with our hands again. We need to get our skilled labor back to work. We’ve found that people will pay slightly more for something made here, especially when it means jobs. There’s a lot of repair work now. We are repairing and recutting diamonds from 20-pointers on up, and modernizing some of the recycled diamonds. Women who have worn their diamond jewelry for years can sometimes cause the diamonds to become abraded, chipped or broken and in need of some TLC.”

Although Sheth says no one was laid off at Nice Diamonds during the downturn, and business volume is catching up to 2008’s level, the recession “made us more efficient and the productivity of everyone in the company has improved. We’re working more hours, making more calls.” The closing of weaker companies during the recession also gave Nice room to grow and capture a bigger share of the market.

For Nice, along with other wholesalers, the range and type of goods also has changed. “We’re still doing our fancy colors and antique cuts but we’re also selling more promotional goods,” Sheth says. In the mass market, promotional goods for price-point items carried tags of \$99 or \$149 or \$199. With the recent rise in the cost of precious metals and stones, retailers wanting to maintain those price points had to come down in size or quality.

Sheth says the company also is doing more with new items, such as treated blacks and natural champagne and cognac colors, that are being marketed by individual manufacturers. He cites LeVian's Chocolate diamond collection as a good example of a successful marketing plan.

"As a company, we have evolved into a jewelry company," says Goldberg. "The whole profile of the business has changed in the past 10 to 15 years. Right now, we're proud to be making beautiful jewelry. We're selling to the same customers we've been selling to for 20 to 30 years. Today, instead of buying diamonds from us, they're buying necklaces and earrings and rings and finished jewelry. We're working to get great images on the website. And we go to the important shows, Basel and Hong Kong."

"I walked in to the office the other day and there were three calls from people wanting to sell jewelry,"

says Goldberg. "You buy jewelry for a wedding, an anniversary. We would like to grow our American business." Telonis refers to the phenomenon as "specific purchases for specific events. Frivolous impulse buying is done. Retailers trying to win new customers are forced into doing lots of jewelry events and promotions."

In Asia and India, the newly wealthy want to buy diamonds. "Maybe new wealth in the U.S. is more of a jeans and t-shirt group," says Goldberg. "Also, we're safe here. The government is stable. People are not worried about having to pick up and go and carry their wealth with them."

LOOKING TO THE FUTURE

Despite all the talk of the huge potential of the rising middle class in emerging countries, VanderLinden isn't convinced that the emerging middle class in India will

\$18.6 BILLION

U.S. 2010 Diamond Imports

says Rosenberg. "No one called wanting to buy. I used to go overseas every 60 days to buy stuff. Now I go to auctions, I go to estate sales, I buy on the street. This is the third year I am not going to JCK Vegas. I've been in business 30 years. All the customers I need to know, I already know. There are no new jewelry stores, no new jewelry superstores, no new Class A jewelry stores. It's all second and third generation."

Rosenberg chronicled the evolution of his company. "Over time, I went from buying melee to half carat, then to carat stones, then to 2 carat, then 4- to 10-carat stones. Then I moved into color. Finally, I had my own patented cut but I couldn't get enough rough to keep the cut alive. Where is the room for the American dealer? Where do I go next? There's no place to move. This is the reason my son is working in another industry."

BEYOND THE CRISIS

Wholesalers point out that the U.S. diamond market — on the wholesale, retail and consumer levels — also is impacted by a number of social and economic forces. "One reason everybody in Europe, Belgium and Israel is trying to sell to China instead of the U.S. is that U.S. buyers don't pay as well," says Telonis. "It's a struggle to get U.S. buyers to pay in 90 days. China pays in 30. And sellers also can get their asking price in China."

"In the U.S., it's a problem and it has always been a frustration that jewelry purchases are occasion driven,"

be buying diamonds anytime soon. "If you've been to Mumbai, as I have, and you've walked down the streets and you've seen the way some people are living, you have to wonder. As they get more disposable income, don't you think they might want to spend it on a refrigerator, a washer, a nicer place to live, maybe even a savings account? If they're trying to build a better life, do we really think diamond jewelry is going to be on their minds? I don't think so. Maybe in five, seven, eight years. But right now, I will bet they have other priorities."

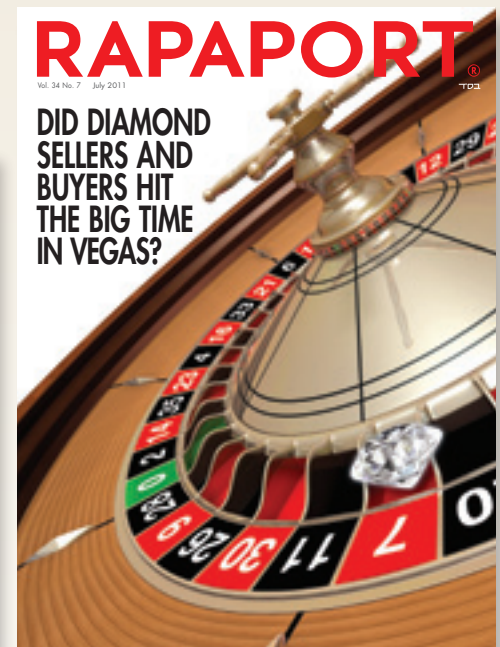
Although Friedman warns not to "count the U.S. out as a diamond consumer," he also admits that "U.S. consumption will not play as big a role in global consumption in the future. The developing countries will become enormous consumers because of where their economies are in terms of growth."

Sheth is confident the U.S. market and wholesalers will have a very strong presence in the world in the future, mainly due to the sheer size of the U.S. economy. "It will take many years of exceptional growth in the BRIC countries and even then, they'll not be able to catch up to the current U.S. market size."

"There are still many opportunities for our industry to do business in the U.S.," says Goldberg. "In addition, we have an educated consumer who is smarter than ever. Diamonds have a lot of good advertising, good press, a good buzz. In many ways, the industry seems to be in a strong place and in strong hands." ♦

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