



THE EVOLVING FACE OF
LUXURY

**IN THE GULF:
ON OUR WAY TO A
NEW NORM?**

CHALHOUB
WHITE PAPER
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Introduction

“There is nothing permanent but change.” - Heraclitus 535BC

After a quarter century of strong economic growth - averaging 5.6% annually across the six countries¹ of the Gulf Cooperation Council (GCC) between 1990 and 2015 - the region is facing headwinds from forces both familiar and new.

In a context of fiscal and geopolitical change, economic growth has slowed from 3.3% in 2015 to an estimated 2.7% in 2016, just below the global growth forecast of 2.9%². Reflecting this economic trajectory, luxury in the Gulf, which enjoyed three decades of rapid and strong growth, is now experiencing a more moderate growth.

Beyond these new dynamics, the Gulf region is going through a period of transition, in which structural transformations are shaking the foundations of the established environment and challenging the way business in local markets has operated for decades.

Governments in the region are announcing adjustments to their systems of social welfare and taxation, and imposing new regulations in areas such as consumer protection, sustainability and local employment.

Similarly, the luxury sector in the Gulf is going through a series of metamorphosis with changes happening in the retail landscape and shifts redefining luxury consumers' profiles, which will undoubtedly re-shape the outlook of the luxury market in the coming years.

In this White Paper - the fourth by the Chalhoub Group - we draw on the Group's 60 years of experience working in the Middle East, as well as our proprietary market research, interviews with industry experts and analysis of third-party data to explore the above mentioned evolutions. We also aim to provide a guide to today's market, offer a glimpse of what the Gulf's luxury sector might look like at the end of this current transition and offer hints on how to cope with the changing luxury eco-system.



“2015 was very challenging for the GCC region, both geopolitically and economically. The drop in oil prices, along with exchange rate fluctuations, is affecting our Group's financial growth. As the leading partner for luxury across the Middle East, it is our responsibility to look beyond these geopolitical and economic fluctuations, and go deeper to understand the profound forces that are reshaping luxury in the Gulf. We have been in the region for over 60 years and have faced many changes and challenges during this time. In overcoming each one, we have reinforced our leadership position. It is our duty and our role to try to anticipate change and make the right moves to help our partners succeed in the region. Through this White Paper, our aim is to present what we see as the new face of luxury and to share our knowledge with our partners. Together, then, we will be ready and well-equipped to welcome this New Norm.”

ANTHONY CHALHOUB - co-CEO Chalhoub Group

PART I

Gulf countries heading towards a more developed model

1.1 Economic adversity

a. The end of a model relying on oil and abundance

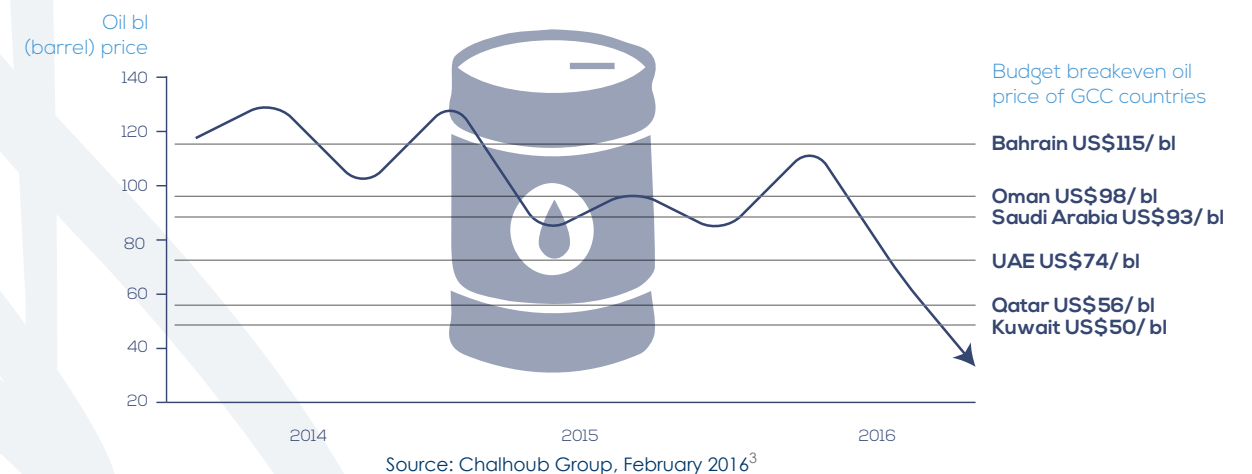
With oil prices at historic lows and not expected to recover for several years, the period of sustained abundance that Gulf countries were experiencing, thanks to large oil revenues, appears to be reaching an end.

After averaging between US\$80 and US\$100 per barrel for years, oil prices fell to approximately US\$30 per barrel by the first quarter of 2016, leaving countries facing budget deficits.

At the same time, expanded military operations by Gulf armies in Yemen, Iraq and Syria are increasing their expenditures on military and security budgets.

Consequently, countries across the Gulf are carefully reducing or eliminating long-standing subsidies on petrol, natural gas, diesel, electricity and water, and considering the implementation of a VAT and expanded corporate tax schemes.

Drop in oil prices



b. Adverse currency effects

Although the sharp drop in oil prices has undeniable effects on the GCC countries' economic situation, the fluctuating currencies in the region have also impacted growth. Pegged to a strengthening US dollar, rising local currencies have impacted the competitiveness of Gulf countries and made life in their cities artificially expensive.

These important monetary variations have put pressure on the GCC countries to perceptibly mobilise their reserves to sustain parity. The pace at which reserves (especially in Saudi Arabia) are consumed and the acceleration of cash outflows seem to put into question the durability of the currency parity as illustrated by speculative moves on the markets.

c. Dampened consumer sentiment

The combined impact of government belt tightening, wider Middle East political uncertainty, Gulf military actions and currency fluctuations is putting negative pressure on consumption across the region. The end of 2015 saw consumer's confidence soften in the United Arab Emirates, with consumer recessionary sentiment rising to 53% at the end of 2015 (up 10% compared to the third quarter of 2015)⁴.

Gulf nationals, as well as the large expatriate workforce, tend to become more prudent with their finances and to delay spending in such an environment. In the last quarter of 2015, 38% of Middle Eastern consumers planned to save money, and cut spending on new clothes, out-of-home entertainment and take-away meals⁵.

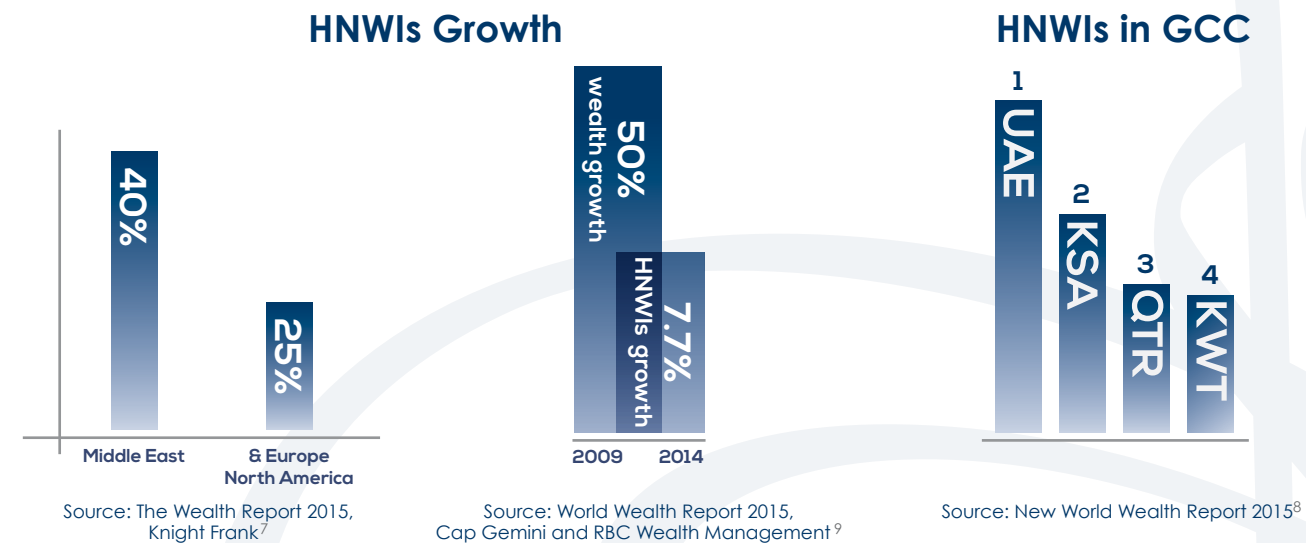
Besides, strong local currencies have encouraged nationals and expatriates to reduce luxury spending locally, in favour of buying fashion goods in Europe, where the relative price can be significantly lower. A 2015 study conducted by the Chalhoub Group showed that, on average, beauty products purchased in the Gulf were more expensive than comparable products available in France and the United States. As a result of the price gap between the Gulf and Europe, outbound luxury purchases from the region increased by 38% during 2015, compared with 2014⁶.

1.2 Structural changes: New consumers, New drivers

a. Potent consumption prospects

While the situation may appear more challenging in the Gulf due to current economic and financial events, the region still benefits from favourable consumption dynamics.

Indeed, the number of high-net-worth-individuals (HNWIs) and their wealth is actually increasing. Gulf countries are home to an impressive number of HNWIs: in the years leading to 2024, HNWIs in the Middle East are set to grow by 40%, compared to 25% growth in Europe and North America⁷. The UAE topped the list of Middle East countries with 72,100 HNWIs; Saudi Arabia was second with 59,000, and Qatar was third, closely followed by Kuwait⁸. In fact, wealth in the region even grew by 50% over the 2009-2014 period and the number of HNWIs grew by 7.7% in 2014⁹.



Simultaneously, the region is seeing a vigorous middle class, supported by labour regulations that are drawing more Gulf nationals into the workforce and an increasing spirit of entrepreneurialism. In Saudi Arabia, for example, it is estimated that 67% of Saudi families are in the middle class¹⁰. Since middle class consumers everywhere are known for their aspirational purchases, a strong middle class suggests flourishing demand for a wider range of goods and services.

Alongside this, women across the region also constitute a growing group of consumers with promising purchase power. For instance, the participation rate of women in the Saudi workforce and their rising enrolment in education contribute to the rising demand for product purchases, as more women with disposable income spend money on grooming and apparel goods.

This is bolstered by the blossoming fashion consciousness of Gulf women, as they are increasingly exposed to global fashion trends through digital media and increased outbound travel. In fact, women in the Middle East control over a third of the wealth in the region; 105 female HNWIs in Saudi Arabia and the UAE hold nearly US\$22 billion in wealth¹¹.



b. Favourable social drivers

On the road to empowerment, women have made great strides in exerting their positive influence in Gulf societies and moving beyond the traditional confinements of home and family. They comprise an increasingly large segment of the university population, representing a valuable talent pool (female literacy in the GCC is 91%, up from an estimated 84% a decade ago¹²). Motivated and ambitious, women in the Gulf region are taking on increasingly prominent roles as educators, professors, university deans, researchers, businesswomen, medical professionals and government ministers.



The UAE, for example, is tapping this resource by making the working world more appealing to women through gender equity projects such as the Gender Balance Council. As H.E. Reem Al Hashimy, Minister of State for International Co-operation and Director General of Dubai Expo 2020, stated at the Global Women's Forum 2016, "The tide is slowly turning. [Men and women in the UAE are collectively working together] for the betterment of our community, our country and our region."¹³

Women also assert their influential role by creating their own businesses and companies. Today, women from the Middle East are establishing one of every four new start-ups, particularly in technology, fashion and media.¹⁴

There is actually growing momentum regionally to support entrepreneurial endeavours. Governments are backing entrepreneurialism and the small business start-up culture through business support and incubation organisations such as the Khalifa Fund for Enterprise Development and Dubai SME. These governmental initiatives arose to support the growing appetite among Gulf young people to launch their own projects and create their own job opportunities.

These youth are eager to throw themselves into the working world, and they see a university degree as a way to succeed. As a result, tertiary education enrolment rates are rising in the UAE, reaching 22% in 2014, versus 16% in 2007. Saudi Arabia accounts for 70% of the GCC's total education budget¹⁵. The quality of this education is being enhanced by the creation of local campuses of prestigious universities such as INSEAD, New York University and La Sorbonne, which are all contributing to talent development.

These young people, particularly Millennials, are unsurprisingly playing a more active role in redefining social and economic dynamics in the region. 50% of the population in the region is under 30 years of age¹⁶, creating a youth bulge that presents governments with a demographic opportunity to propel their nations forward. The Gulf young people bring creativity, energy and productivity to the economy, potentially accelerating the continuous development of non-oil sectors and expanding knowledge-intensive industries.



"The dynamic shifts in the region's economic, demographic and social landscape will continue to impact the higher education sector in the Middle East. Institutions of higher education throughout the region are contending with a young regional population and are catering to their requirements in sync with the overall needs and demands of the marketplace. In tandem with its strategic vision, AUS has charted a course that keeps these various factors in sight, offering a wide variety of business programmes that prepare the student for a dynamic and competitive global marketplace."

BJÖRN KJERFVE - Chancellor of the American University of Sharjah

1.3 A new business order

As part of their efforts to develop the non-oil sectors of their economies, GCC governments are working to improve the business climate, attract foreign investment and strengthen exports. This includes steps to diversify their economies and move towards amending the region's fiscal, regulatory and governance frameworks.

a. A more diversified economy

For decades, Gulf countries have worked to transform large oil revenues into a more sustainable economic model. They have used this oil income to diversify their economies, build crucial infrastructure and enhance important social services such as education and healthcare. However, by diversifying their economies, Gulf governments are charting a more sustainable, less volatile development course that will be spearheaded by knowledge-intensive, rather than hydrocarbon, sectors.

A key part of this effort for diversification has been the implementation of large economic development and infrastructure projects, often linked to industrial diversification and to the hosting of international events. Qatar, for example, is expected to award US\$200 billion worth of large projects over the next 10 years¹⁷, in part driven by preparations to host the 2022 FIFA World Cup. Dubai is hosting the 2020 World Expo; Abu Dhabi is developing three new urban districts; Kuwait is building the City of Silk, and Saudi Arabia is building six new economic and industrial cities¹⁸.



Tourism is a key sector in this diversification: Gulf countries are building more hotel rooms, shopping malls, theme parks, and even setting up more entertainment festivals to draw these visitors. Dubai, for example, wants to attract 20 million visitors by 2020. By 2030, Abu Dhabi is expecting more than 7.9 million and Qatar is targeting 7 million¹⁹. One of the most high-profile developments coming on stream is Abu Dhabi's iconic Cultural District, which will see the opening of three world-class museums: Le Louvre, the Guggenheim and the Zayed National Museum.

Similarly, this demonstration of vitality and dynamism is showcased in the cultural sector as other cities are also adding history and art museums to their cultural portfolios. In Saudi Arabia, while religious tourism is expected to bring 30 million visitors by 2025²⁰, major tourism-related projects are planned over the next 10 years. Examples include the new 450-kilometre-long high-speed rail link between Makkah and Madinah, the Kingdom's first large-scale tourist development in the South of Dammam, and the expansion of Taif's historic Souk - Okaz.

b. A maturing regulatory framework

To be able to support this diversification in a context of lower oil revenues, governments are considering taxations schemes and revising the fiscal, legal and regulatory frameworks in the region with a view to align their models to more global standards.

Increasing taxation

With low oil prices, there is decisive momentum growing in the GCC, particularly in Saudi Arabia and the UAE, to implement a long-debated VAT across the region. Consensus estimates are that the VAT rate will not exceed 5% when put into effect. Adding corporate income taxes is also under discussion. Already in place since 1955 and 2009 in Kuwait and Qatar, respectively, Oman, Saudi Arabia and the UAE also are expected to eventually launch their own taxation systems in the coming years.

“As GCC economies are maturing, they need more stable sources of revenue. The oil price tsunami presents a ‘perfect storm’ opportunity for economic policy reform, including fiscal reform and the introduction of new tax regimes in oil-producing countries.”

Dr. NASSER SAIDI - Former Minister of Economy and Industry of Lebanon and former Vice Governor for the Lebanese Central Bank

Revisiting ownership and employment conventions

As already referenced, GCC countries are changing company ownership laws that in some cases currently require at least 51% ownership and sponsorship by a national citizen. The exception has been in the UAE, where free zones permit 100% foreign ownership. But now Saudi Arabia has announced a plan that could possibly turn the 75% maximum foreign ownership into a full 100% foreign ownership for businesses in certain sectors, including retail.

Change is also coming to labour markets, with greater protection and job flexibility for expatriate workers in countries such as the UAE and Qatar, and implementation of region-wide “gulfanisation” laws that require private sector companies to ensure their workforce comprises a minimum percentage of local citizens. In addition, Saudi Arabia is pursuing “feminisation” laws that mandate that only Saudi women can occupy certain jobs, principally in the retail sector.



CHALHOUB GROUP AND FEMINISATION

Under the feminisation laws in Saudi Arabia, shops selling fragrances and makeup were among the first in the retail sector to move to a primarily Saudi female staff. Wojoooh, the Chalhoub Group's market-leading beauty chain in Saudi Arabia, was quick to adapt to these new labour regulations.

Wojoooh implemented a massive advertising and awareness campaign in newspapers, on social media, in universities and across its stores, announcing job openings for Saudi women. At the peak of the recruitment process, Wojoooh's Human Resource team was interviewing 50-60 Saudi women a day. New employees, many of whom had never worked before, participated in a month-long training programme custom-designed by the Chalhoub Group's Retail Academy. Despite the challenges associated with the new regulations, including a lack of qualified candidates driven in part by cultural norms that discourage women working, Saudi women constitute more than 50% of Wojoooh staff in Saudi Arabia today and some of them are delivering outstanding performance.

Expanded consumer protection

These regulatory changes extend to consumer protection, where beauty product registration has existed for years, to guarantee more transparency in countries such as Egypt, Bahrain and even Saudi Arabia, where the SASO (Saudi Arabia Standard Organization) has been delivering certification since the 1990s. The UAE has contemplated this undertaking too, while Saudi Arabia and Kuwait now demand tests of components to be conducted in laboratories before products can be sold in the market.

CHALHOUB GROUP'S INVOLVEMENT

To ensure a smooth registration process, the Chalhoub Group operates special compliance teams to prepare the required documentation in Arabic and other languages for each product and then follow up on the registration process with local authorities to ensure fast approval.

Improved corporate governance

Complementing these regulatory changes are measures designed to improve corporate governance, as more companies appoint external advisors to encourage more strategic and “out-of-the-box” business thinking. Organisations such as the Pearl Initiative, which is supported by 40 companies including the Chalhoub Group, promotes higher business standards in areas such as corporate governance, anti-corruption, codes of conduct, integrity and reporting. Moreover, the introduction of taxation will eventually make companies set up specific business systems that will drive more accounting transparency.

“For decades, private companies, perhaps because they were not expected to pay taxes, didn't really see the point in publishing reports or accounts. The regulations haven't changed that much, except possibly for publicly-listed firms, but what has changed is the increased sense that there is a strong business case behind good governance, and that's really what the Pearl Initiative has been driving.”

BADR JAFAR - CEO of the Crescent Group, Founder of the Pearl Initiative

PART II

The impact on the luxury sector

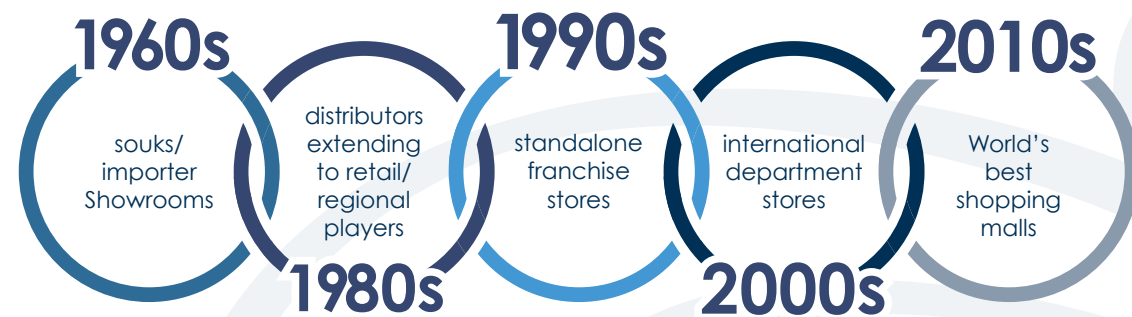
It is undeniable that for the past two years, the environment in which the retail sector operates has been evolving. Transformations that seemed only visible on the surface have actually profoundly shaken the structure of a world that had previously only been observed through the lens of familiar norms. These profound changes are reshaping the regional landscape and remodelling the face of the Gulf luxury sector.

2.1 A more challenging operating environment

a. Growth slowing down

The changes happening in today's regional luxury market come after a period of expansion stretching back to the 1980s. This was a period of generally strong GDP growth, large development projects, a booming retail scene and an increasing range of brands available locally - positive dynamics that were reinforced by active retailers and engaged distributors. During that time, the market transitioned from a limited footprint of luxury products found mainly in souks or showrooms, to a large selection of products offered in franchise stores and world-class department stores located in globally acclaimed shopping malls.

The phases of luxury footprint expansion in the Gulf



Source: Chalhoub Group²¹

Over the past 12-18 months, as the worldwide luxury market softened, so too did luxury in the Gulf. After registering annual growth over the past five years of approximately 6% to 8% at a constant exchange rate, the luxury dynamic in the region moderated to a real year-on-year growth - at a constant rate - of just 1% to 2% in 2015²².

Concurrently, the strong appreciation of the region's dollar-pegged currencies - as was noted previously - have made goods priced in local currencies more expensive, both to residents and tourists (especially those coming from Europe, Russia and China). Since early 2014, the values of the Chinese Yuan, the Euro, and the Russian Rouble have fallen against the dollar, and local currencies, by 6%, 20% and 52% respectively²³.

b. The 'tourist effect' on luxury spending

Tourists have traditionally been a significant market for luxury goods in the region, but the strength of both the US\$ and local currencies is impacting this convention. The result is that although overall tourism arrivals to the Gulf were up in 2015 (+8% in Dubai and +15% in Abu Dhabi)²⁴, tourists spent less on luxury goods, driving overall luxury spending down by 7% in 2015²⁵.

This was influenced by a nearly 50% drop in the number of Russian tourists in Dubai²⁶, who had always been the most important luxury spenders in the region (US\$888²⁷ monthly on luxury clothes, bags and shoes). Chinese visitors' spending was also down by 57%, even as the number of arrivals to Dubai increased by 1/3 in 2015. A weaker Yuan and the Chinese government crackdown on corruption and corporate gifting took their toll on Chinese tourists, who (with Russians) accounted for more than 25% of the overall tourist spending in the UAE in 2014²⁸.

In such an environment that combines slower luxury consumption and rising tourism arrivals with a changing visitor mix, only the brands that understand that they have to adapt their offerings to the needs of these new consumers and capture their attention will remain competitive.

"The regular price comparison surveys we conduct across major international shopping destinations highlight huge differentials in pricing, with Gulf price tags among the most expensive ones. That is why, in early 2015 we began to lower some retail prices by reducing our margins and renegotiating purchasing orders."

FADI JABBOUR - Chief Operating Officer of Chalhoub Group Retail

c. Significant operating costs

Adding to pressures in the sector, already notable operating costs are heading higher. In recent years, with the increased appetite from brands to penetrate the Gulf, costs of running retail operations in the region further increased, with some leasing rates having tripled in recent years. These rates are comparable or even higher to those found in some of the world's most prestigious locations, such as the Champs-Élysées in Paris - though not as high as New York or London. Even as the economy moderated in Dubai between 2014 and 2015, rent in some key locations continued to increase.

"Rental costs across the region are definitely something that retail companies need to carefully monitor as leasing rates are reaching higher levels than before. In a region where the retail culture is immensely relying on mall presence and flagship developments, managing these costs requires more discernment and agility. With each renewal term comes the difficulty for retailers to negotiate leasing contracts and conditions, as well as mitigate the pressure rental hikes induce."

DAVID VERCRUYSE - Former General Manager, Sephora Middle East

Also, compared with recent historical regional benchmarks, staff costs have risen over the past few years for several reasons:

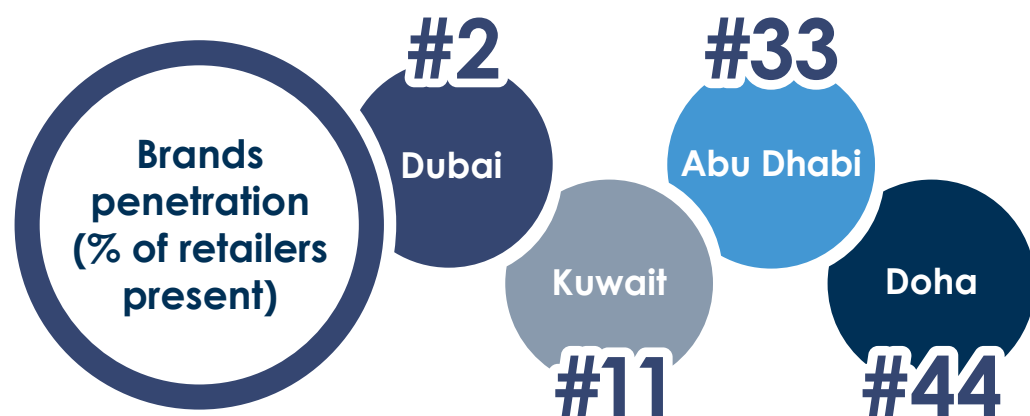
- Increased operating hours set by malls (7 days a week and from 10am to midnight during week-ends).
- Demanding customers who increasingly expect to receive the same service standards as in Europe (this requires investments in developing competencies and increasing the number of staff serving customers).
- The ongoing requirement to have increasingly competent staff and to invest in their training and development.
- The necessity to manage staff turnover which is structurally higher than in Europe and implies higher indirect costs such as recruitment, training and administrative management.

d. Retail footprint and retail destinations amid changes

In parallel, the luxury sector is also being impacted by the maturing retail landscape. The steady development of shopping malls, which significantly increases available retail space, puts more regional cities at levels comparable to (or sometimes ahead of) developed markets. For instance, Dubai will reach GLA (gross leasable area) rates of 1.4 square metres (sqm) per capita in shopping malls - comparable to the 2 sqm per capita in the United States²⁹. In addition, approximately 18 million sqm of retail space is due to open by 2020 in new shopping malls, primarily in Saudi Arabia, the UAE and Qatar.



This trend not only demonstrates that the retail panorama is still expanding, it also attests to the tough competition between brands in the sector. In fact, luxury brand presence has now attained levels close to saturation across the region. For example, Dubai was even ranked second behind London in the percent of global brands present, while Kuwait City was ranked 11th 30.



Source: CB Richard Ellis, 2014³¹

The strong concentration of luxury brands across the region is also on par with the quality of the retail offering. Diverse shopping areas are now being developed to address consumer demand for more variety of shopping destinations. In Dubai, the focus was long on large-scale malls. Now, there is an increasing trend towards community malls (such as Nakheel at Jumeirah Park Pavilion, Sunset Mall, J3 Mall) and districts of open-air street-front stores (such as The Beach in JBR or CityWalk in Jumeirah). By contrast, Saudi Arabia is seeing a trend towards larger malls with a luxury positioning (like the Al-Diriyah Festival City Mall and Riyadh Avenue Mall), something relatively new for a retail environment formerly and more prominently defined by community malls and luxury stores located on street fronts.

Although this expansion will help drive luxury growth through 2020, beyond that point, achieving organic growth will require a more strategic approach to leverage the untapped growth potential each store brings, instead of solely focusing on network enlargement



“For years, two-thirds of the luxury sector’s growth rate was mainly driven by the expansion of retail offers and the opening of new stores. After 2020, this expansion may slow down, which will put pressure on the sector’s comparable growth and productivity. Growth will not only result from the replication and the good execution of international proven concepts. Strategies of differentiation will prevail.”

CYRILLE FABRE - Partner at Bain & Company

2.2. A metamorphosis: Maturing consumers, growing categories and digital emergence

a. Evolving consumers

The pace and depth to which global luxury brands have penetrated the regional markets testifies to the passion that Gulf nationals have for luxury goods. The Chalhoub Group research reveals the extent of affluent Gulf national spending, which - driven by the desire to indulge - reaches US\$2,000 a month on fragrances and cosmetics, ready to wear, shoes, bags; US\$25,000 on watches and jewellery; and US\$10,000 annually on gifts³². This consumption is also driven by the ability of brands in the luxury sector to deliver on customers' expectations. As well, it supports Gulf customers' need for distinction, which allows them to define their place in society³³.

However, Gulf consumers are changing and so are their luxury consumption patterns. Increasingly mature and well-travelled, they are more connected digitally and tuned-in to the outside world. This makes them increasingly demanding and aware of what they want: variety of choice, high quality, fair value, exclusivity and unique products that will bring them enjoyment, satisfaction and recognition. As described in the 2014 Chalhoub Group White Paper *Gulf Luxury Consumers: A World Apart?*, luxury consumers in the Gulf generally fall into three archetypes: the Horse, the Falcon and the Gazelle.



The gazelle

self-expression,
social media,
Western influences



The horse

status-oriented,
social acceptance,
national influences



The falcon

enjoyment,
experiences,
personal relationships

Source: Chalhoub Group White Paper 2014, "Gulf Luxury Consumers: a world apart?"³⁴

While traditionally, most luxury consumers embody the "Horse" archetype (66% driven by status and reassurance), luxury consumers in the region are increasingly becoming Gazelles (29%) and Falcons (5%). Indeed, research conducted by the Chalhoub Group and Bain & Co in 2015 found that luxury consumers are beginning to move away from a materialistic take on luxury towards the appreciation of luxury for the feeling of accomplishment and the enjoyment it brings. They like to share products, experiences and moments.

Because they seek a greater sense of purpose and satisfaction, consumers find that the purchase of luxury experiences often fulfils these wishes better than the purchase of luxury things. Younger customers are interested in "new" and more experiential-focused consumption. This "experiential" theme equally applies to Millennials, who tend to define themselves by what they experience rather than by what they own.



Source: The Future Laboratory³⁵

As a result, the Gulf luxury market can no longer be approached as a laggard market, where consumers will buy anything stamped with a foreign logo or brand. An elevated brand experience propels brands forward, as this makes luxury customers feel courted and wanted.

LEVEL SHOES by CHALHOUB GROUP

Level Shoes store in Dubai Mall delivers a captivating experience to customers by offering a new take on shoe fashion, art and design.

Level Shoes is an immersive shoe experience across 9,600sqm, offering luxurious and bespoke collections, hip young designs and fashion-forward offerings. From the concierge service, to the Sole Lounge for a pampering treat, from dedicated stylists to The Cobbler bespoke offering, Level Shoes is all about delivering a personalised shopping experience. VIP guests can indulge in a wide array of special services, tailored to their tastes and demands.



b. Growing categories

Changing consumer behaviour is mirrored in the dynamics of market categories. Previously, the prestige beauty market was driven by fragrance, but now it is moving towards an increased selling of make-up products - especially in the UAE. While fragrance still represented 56% of the overall Gulf prestige beauty market in 2015, its market share was down by 3% from a year earlier. Concurrently, the make-up market share grew by the same amount to represent 37% of the overall Gulf market. Skincare remains relatively small, at 7% market share³⁶.

New retail formats are also changing the beauty scene across the region, with the boost in niche fragrance brands, stand-alone shops (such as MAC, Make Up For Ever and Bobbi Brown) and the success of Sephora.

“Make-up is driving the growth of the prestige cosmetics industry everywhere in the world. This momentum is due to intense and high-quality innovation, and reasonably priced products, compared to other categories. The brands that now lead the industry have emerged over the last 10 years, bringing a lot of freshness and creativity, while being much more accessible than established brands. This is seen, first of all, in terms of positioning but also in terms of price. Benefit is possibly the best example of this new generation of leading make-up brands.

Considering that make-up has always shown a strong resilience in the context of tough economic environments, you can be convinced that its contribution will rapidly grow in the Middle East too.”

PATRICE BROSSON - Regional Manager Benefit Cosmetics Middle East & Africa

Other changes impacting luxury include the rise of ready-to-wear and the decline of accessories; a move towards casual wear, as exemplified by the sneaker phenomenon, and away from formal wear; and the return of jewellery at the expense of watches. The strong attachment that local consumers have towards traditional rituals is also obvious in the emerging interest in halal make-up and designer abaya collections.

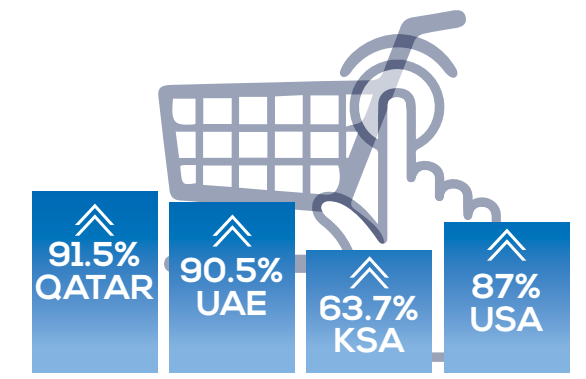
c. Digitalisation

These new retail dynamics are directly related to the 'big entrance' that digital has made in the luxury retail sector across the GCC. This is no surprise in a region where internet penetration is so high: 91.5% in Qatar, 90.5% in the UAE³⁷ and 63.7% in Saudi Arabia, against 87% in the USA. Youth, and in particular Millennials, who seamlessly transition from online shopping to in-store experiences in their quest for the best products, are helping drive this trend.

Traditional marketing and even the conventional in-store retail experience are being upended. Consumers are now connected all the time, using social media such as Facebook and Instagram to connect with each other, share good experiences with like-minded people and interact with brands.

Moreover, e-commerce - although still in its infancy - is growing year after year (doubling its size in 2014 and growing by 50% in 2015), as more and more consumers are willing to shop online. At the same time, brands have integrated sites archiving their systems and have developed adequate processes to ease logistics and payment challenges.

Internet Penetration



Source: The World Bank, 2014³⁷

2.3 Positive prospects for the future

a. Growth for the long term

Sector developments aside, countries and retail markets across the region have multiple causes for optimism. Despite global and fiscal headwinds, Gulf countries are still expected to see higher GDP growth (averaging 2.9% annually through 2018) than countries in Europe (1.7%) or the United States (2.4%)³⁸. Despite the low oil-price environment, the region still has some of the largest reserves of hydrocarbons on the planet, providing a reliable source of income for the long term and fuel for their economic diversification efforts.

b. New horizons: Iran, Egypt and Morocco

Additionally, several regional countries, including Iran, Egypt and Morocco, offer interesting opportunities for the development of retail projects.



With the lifting of sanctions, Iran is expected to see annual GDP growth of 6.2% a year through 2018³⁹. An important market for the Chalhoub Group during the 1960s and 1970s, Iran offers opportunities for luxury brands with its 80 million inhabitants (the total GCC population is 52 million), its young, well-educated population, a relatively large urban population, a sizable middle class, higher education rates (especially for women), and a long tradition of sophistication and eager adoption of technology.

Today, social media is helping many young Iranians interact with the outside world. Young people have become emboldened in how they relate to fashion, especially Western brands. Western luxury brands have returned the interest, beginning at the first-ever Tehran Fashion Week in 2014⁴⁰. This is indicative of the changing way women and men are dressing, and how boundaries are being pushed. The Iranian fashion scene is blossoming with the rise of local high-street fashion and emerging talents (e.g. Poosh by Farnaz, Abdoli, Coralin Design, and Naghmeh Kiumarsi).

“The retail market in Iran is moving from the streets towards the shopping centres. This transition from the traditional bazaar is being hastened by the westernisation of the young people’s taste in the country.”

ALI AMIRI - CEO of MAAD Retailing Studies Centre



In the meantime, Egypt appears to be experiencing greater political stability and could see 4.6% GDP growth annually through 2020. Despite its current financial challenges, the market looks promising: it has a large population of nearly 90 million, the middle-class is developing steadily and encouraging factors have emerged, such as the recent discovery of large natural gas fields and the government’s implementation of major infrastructure projects, such as the ambitious Suez Canal Development.



Also, Morocco is an exciting and potentially lucrative investment destination for retail companies. The consumption landscape is changing, with the rising demand for brand names and quality by the upper-middle class and wealthy. Morocco’s steady growth and political stability represent major factors in the country’s growing influence in Africa too, positioning it as a business gateway to North and West Africa.

PART III

A promising future: embracing the New Norm

As change in the region redefines the context in which the luxury sector operates, luxury retail players must now adapt to a new set of standards. This new environment requires that luxury players, looking to thrive in the region, take a more thoughtful and more engaged approach to embrace what we can call a ‘New Norm’.

This approach requires continuous development of relevant knowledge in a constantly changing region, consistent delivery of efficiency and price competitiveness, and a commitment to putting customer-centricity and innovation at the forefront of any brand or concept development strategy.

3.1 Building knowledge and expertise

a. Knowing the region and its regulatory framework

Gulf countries are transforming quickly. With regulations evolving, knowing what they entail and ensuring strong compliance is a priority. The increased focus on governance and regulatory enforcement means deeper scrutiny to avoid risks and seize appropriate opportunities.

Given the complex nature of the region’s dynamics, an in-depth knowledge of the broader environment, its influential players, its customs and its traditions is increasingly crucial. It is even more important since the region is comprised of several countries that have both similarities and significant differences in areas such as regulation, institutions, culture and influencers.

Similarly, because decision-making involves a tradition of public and private consultative discussions that can sometimes be hard to grasp for outsiders, official decisions can sometimes appear to be delayed and then resurface at a later stage with a mandate to be promptly implemented.

Such an environment requires utter responsiveness, profound flexibility and the ability to anticipate “black swan” events that carry big risks for those who do not know how to react accordingly with the necessary agility and proactivity.

b. Understanding local markets and consumers

For luxury players, knowledge is therefore essential when working in the region. Top executives, marketers and product developers of fashion brands need to be able to combine an in-depth knowledge of international trends with an understanding of local GCC cultures.

With this dual awareness, brands and retailers are empowered to develop relevant product offerings designed to appeal to local customers (e.g. in 2014, H brand launched the first halal nail polish line with increased water permeability to allow water to penetrate through to the nails to meet the requirements of purification rituals before prayer).

“It is important that the salesman really understands the product he is selling; it is not just selling shoes. I need to know what they are made of and how they are made.”

Male, Abu Dhabi

CUSTOMER INTERVIEWS FOR THE CHALHOUB GROUP by METHOS

Likewise, this knowledge should be shared by sales staff who are on the front lines interacting with customers. As revealed in the Chalhoub Group’s most recent consumer research, 82% of luxury shoppers expect salespeople to demonstrate knowledge of brand history and product expertise. An even larger number, 85%, want salespeople to be aware of the latest trends. For sales staff, building expertise and a thorough understanding of the brands and categories they represent, as well as the wider marketplace, builds their professionalism and their ability to address customer expectations.

3.2 Being customer-centric

a. Being a storyteller

Retailers must use brand knowledge, retail expertise and customer understanding to deliver a compelling customer experience. This includes ensuring that sales staff are skilled at discussing a brand's history, heritage and values. Successful luxury brands build genuine relationships with their customers, not because they sell sought-after products, but because they invite them into their world. With storytelling, brands have the ability to captivate customers and take them on a journey they yearn to experience.



Sales staff certainly represent a wonderful pool of brand advocates because they can share brand stories, explain to customers what a brand is about and give products an identity. Visual merchandising also plays an important part in conveying brand stories to customers as it enables customers to understand the story at first sight. Window displays often present customers with evocative designs to welcome them into the brand's universe. By adding a sense of theatre to the shopping experience, visual merchandising is a powerful storytelling device that drives customer engagement.

Storytelling helps capture customer attention by allowing retailers to convey images about their brand, which subsequently trigger emotions and resonate with customers' own personal experiences. As such, the still-common practice of hard selling a product is no longer an effective sales strategy. In fact, it induces mistrust and raises questions about quality and whether the product is outdated. Instead, brands need to help consumers immerse themselves in the very essence of the brand DNA.

This storytelling should be incorporated into marketing and sales strategies to consistently deliver a differentiating and meaningful customer experience. Given the region's rich tradition of narrative and its demonstrated love of luxury, strategies that weave authentic and meaningful stories across their marketing efforts are the ones most likely to prosper in a crowded luxury marketplace.

b. Recognition in store

Luxury retailers must also ensure that customer experiences are so memorable that their customers bond with their brands and engage in lasting relationships with them. In this battle for attention and consideration, traditional customer relationship management (CRM) techniques (e.g. loyalty programmes based on point accumulation and redemption) are not sufficiently appealing to customers. The new CRM is about putting the customer at the centre of everything a brand does. As such, relationship building in-store is the guiding principle that makes the in-store experience truly luxurious: intimacy, personal touches and, above all, customer recognition.

To successfully engage luxury customers, luxury brands across the region must guarantee that they feel appreciated and welcomed at each interaction. For instance, Gulf nationals are particularly pleased when they are recognised by name. That is why luxury brands in the region should ensure that each customer is treated as a unique individual. As revealed in the Chalhoub Group's consumer research, 82% of luxury consumers expect brands to recognise loyal customers and 77% expect brands to recall a customer's tastes and preferences.

c. Experience taking centre stage

While there is no doubt that middling retail experiences still exist in the region, they are no longer acceptable in the minds of consumers. What's more, hospitality - which is a defining characteristic of Gulf culture - is paramount to the customer experience in the region. Consumers expect to be graciously welcomed into luxury stores as guests, not treated like shoppers, and to have staff anticipate and meet their needs. After all, airlines across the region - such as Emirates Airlines, Etihad Airways and Qatar Airways - have made Gulf nationals accustomed to extremely high standards of customer care.

Retail shops should embody comfort, space and convenience, and in some ways serve as an extension of the customer's home. The brands that manage to incorporate a sense of authenticity and hospitality into their stores will surely make a strong impression on customers.

Moreover, in-store experiences represent an opportunity for brands to go the extra mile to deliver surprises and feel-good attention to strengthen the brand-customer relationship. Sophisticated customers in the region like to be 'wowed'; it is about touching their hearts and dazzling their senses as soon as they step into the store. To do so, the in-store experience has to offer memorable moments that immerse customers in the brand environment.



CHALHOUB GROUP GUEST EXPERIENCE INITIATIVE

The Chalhoub Group's Guest Experience Initiative transforms retail from being purely a "transaction" to also being an "experience." Through their genuine passion and brand expertise, our sales staff engage and connect with customers, who we treat like guests. Customers have to feel unique. To support this, we have identified eight "Moments of Truth" that are key to creating a memorable guest experience. In-store, our teams pay special attention to each of these moments, putting the customer at the centre while demonstrating their passion, and their expertise of the brand, products and categories.

Another element of the Guest Experience Initiative is a proprietary tool for our store managers that is built on our research regarding guest preferences. The tool helps managers regularly 'visit' their stores with guest-centric eyes and evaluate the efforts to deliver a great experience to store guests. The purpose of the tool is to impact business results (sales, units per transaction, average basket and conversion rate).



In light of Apple's cool 'California mind-set' and Sephora's 'entertaining style', it's a given that expert service and outstanding in-store experiences will be tailored to a brand's DNA. That is why in-store experiences must be aligned with the story, the values, the imagery and the emotions brands seek to convey. Delivering a world-class experience has always been an unconditional priority in the Middle East. Now, it is also essential for luxury retailers to ensure that the brand universe is reflected in the in-store experience.

d. Omni-channel strategies

Delivering a memorable customer experience is not just about in-store experience; it cuts across all channels and brand touch-points. Customers expect equally rich brand experiences offline and online. A seamless omni-channel approach across all brand platforms can improve the customer's brand experience and build loyalty. Ultimately, customers want brand experiences that are easy to appreciate, enjoy and live.



Today's consumers increasingly use online shopping tools, e-commerce websites and social media to get inspiration and to buy products. In the UAE, the e-commerce industry is expected to be worth US\$10 billion by 2018⁴¹. Shopping in the Middle East is set to become more sophisticated as an increasing number of retailers sell their products online via e-commerce websites such as Namshi.com, Hijabik.com and The Luxury Closet. The Chalhoub Group also embarked on its e-commerce journey with the launch of online shopping platforms for Level Shoes, WojooH and L'Occitane in 2015.

While luxury customers love to be able to touch and feel a product before committing, omni-channel investments provide consumers with a clear and engaging path from online research to in-store experience.

e. Latest products, tailored offers

Another factor critical to a memorable and delightful customer experience is to carry the brand's latest products, in line with what is available in global fashion capitals. Products should be launched in the Gulf at the same time as in the West. 85% of luxury consumers in the Gulf expect this, which is no surprise given how digital savvy and globally connected they are.

In addition, special lines for Gulf customers, in terms of sizes, cuts, shades and scents, should be launched exclusively in the region, or at least ahead of global markets. This is most applicable to the emerging trend of brand editing, which addresses the tastes of the Gulf consumers (e.g. longer dresses, more embroidery, coloured bags, sandals and oriental scents).

At the same time, there is a growing community of sought-after local designers - including the likes of Bedouin, Bil Arabi, House of Nomad, etc. - that are successfully tickling the curious minds of local fashionistas. The Dubai Design and Fashion Council has even been mandated to help promote talents across the region.



"We like the idea of dressing women all around the world. In the past we have created special collections for countries like China, Russia, Brazil, Mexico and we now wanted to create something also for the women of the Middle East and the Arab community taking into consideration the local taste and adding our Italian touch."

DOMENICO DOLCE and STEFANO GABBANA - Founders of DOLCE & GABBANA

In line with this desire to blend what the West has to offer with the region's traditions and norms, made-to-measure, tailored and customised products and services look particularly attractive for luxury consumers in the Gulf. 'Make it personal' is the new ultimate fashion trend (e.g. engraved leather bags with Arabic calligraphy for instance). Luxury consumers in the Gulf want hyper-personal, brand new, exclusive stock that no one else has.

Exclusivity is a much desired absolute, as it defines true luxury. Products that are clearly exclusive and unique definitely appeal to customers across the region, so much so that brands launch specific items for them. In 2014, for example, Gucci created one exclusive and unique bag - Lady Lock - in Bordeaux crocodile. Just one piece was made and it was destined for Dubai, where it was sold at Bloomingdale's Dubai for AED98,350⁴².

3.3 Enabling price competitiveness

a. The importance of fair value

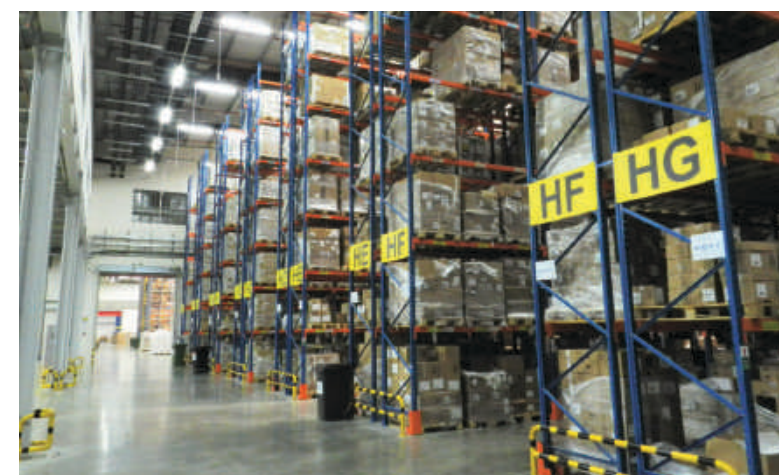
In the quest for the latest products and tailored offers, luxury consumers pay great attention to the quality of the goods they acquire and the price of these goods. Because of frequent travels and increasing digital connectivity, they demand that brands remain price competitive.

Discrepancies in price are more visible than ever, and Gulf nationals do not hesitate to seek information, check prices, talk to their peers and compare to make informed decisions. They will then go to those destinations where prices match the value the products hold. They won't pay more for a product if the quality or level of service doesn't justify it.

Therefore, to retain consumers, it is important for brands to align prices globally. Failure to do so may result in losing customers' trust, which can ultimately undermine a brand's reputation and image. Retailers who ask customers to pay much higher prices for products that are available elsewhere at a fairer value, may end up damaging the trust that is key to the relationship between a customer and a luxury brand.

b. Efficient and streamlined operations

In the face of greater price sensitivity, luxury distribution and retail operations must become more efficient. Efficient operations can help foster price competitiveness, while preserving retailers' bottom lines. In a context of heightened volatility, optimised and streamlined operations can guarantee effective value-chain management. Best practice in this regard includes stricter stock management, cautious distribution policies, supply chain and back office enhancements, optimised category management, and the ability to meet strict lead times.



Because consumption patterns and consumer demand are less predictable, ensuring that supply chain processes are rationalised and fully integrated in the operational chain is paramount. It is even truer when it comes to fashion and category management: only the retailers who define new ways of planning and managing categories can lead on the markets. For instance, better forecasting and automatic replenishment can be improved through the implementation of first-class information systems. This way, brands can introduce new products to customers more effectively and more frequently, while stock levels and working capital are continuously amped up.

3.4 Driving innovation

a. Product and retail concept innovation

In a region focused on newness, product and retail innovation are important avenues to help brands stay relevant and flourish across the region. Since novelty is revered by Gulf nationals, product innovation - particularly in fashion and beauty - is a key contributor to the success of luxury brands.

'BEAT THE HEAT' with WOW by WOJOOH

In the region it is important to 'beat the heat' when it comes to makeup looks. So Wow by Wojooh has carefully crafted all its products to tackle the heat of the Middle East region - from long lasting liquid foundation to waterproof Khôl.



Retail-concept innovation is also a way to present consumers with the breadth and depth of choice they seek. The success of multi-brand specialty stores, which introduce a more specialised offering, can testify to this strong trend.

"Today's consumers are not only looking to purchase a product. They are looking for a memorable experience; they expect to be taken on a journey. TRYANO provides customers with an experience that is simultaneously ALIVE, ENTERTAINING, SPECIALISED and REMARKABLE. The store is inspired by nature's changing seasons, ever evolving and ever changing. We are bringing Abu Dhabi consumers something different: a destination of truly exceptional experiences."

LINTON CROCKFORD-MOORE, Creative Director, Chalhoub Group



b. Luring in-store technology

Implementing technology is essential to retail concept store innovation. Correctly executing in-store technology helps create a mesmerising customer experience. Stores should be digitally-enhanced, providing distinctive experiences, with surprises and novelties, such as augmented reality and 360-degree approaches.

By using 3D printers, intelligent mirrors, iPads, virtual reality glasses, holograms, recognition devices and bio-sensors in their stores, luxury brands can demonstrate their digital sophistication to customers and help ensure their lasting relevance.



Conclusion

The New Norm for luxury in the Gulf is not simply the story of cyclical dynamics such as the economic slowdown, strong local currency movements and low oil-price variations. There is no doubt that these economic headwinds are impacting today's luxury sector; however, they have deeper significance because of what they reveal about more fundamental changes occurring within the Gulf luxury sector itself.

From a 'Wild West' frontier market structure and attitude, characterised by huge untapped potential, luxury in the Gulf today is displaying a more mature face:

- The business environment is more formally defined and framed by regulation addressing governance, labour laws and consumer protection.
- The region has one of the highest rates of luxury brand penetration in the world.
- The physical retail environment is expanding, both in terms of gross leasable area and in the variety of shopping environments available. It could reach international standards by 2020.
- Customers are more perceptive and price sensitive: highly travelled, they compare prices, service quality and availability of the latest products.

Now that this maturing process has begun, we expect it to evolve rapidly, as is often the case in the Gulf. Change can happen quickly, given the energy and the ambition of a more qualified, younger and entrepreneurial population. The region has the capacity to evolve and to find its own way, while taking inspiration from international best practices.

With that in mind, we are seeing a promising future for luxury in the Gulf. Nevertheless, thriving in the region will require more work and planning, and increased energy and agility from all stakeholders. In light of this maturing market, the role of the local distributor is evolving into that of a local partner, with the relevant expertise to support brands in their development.

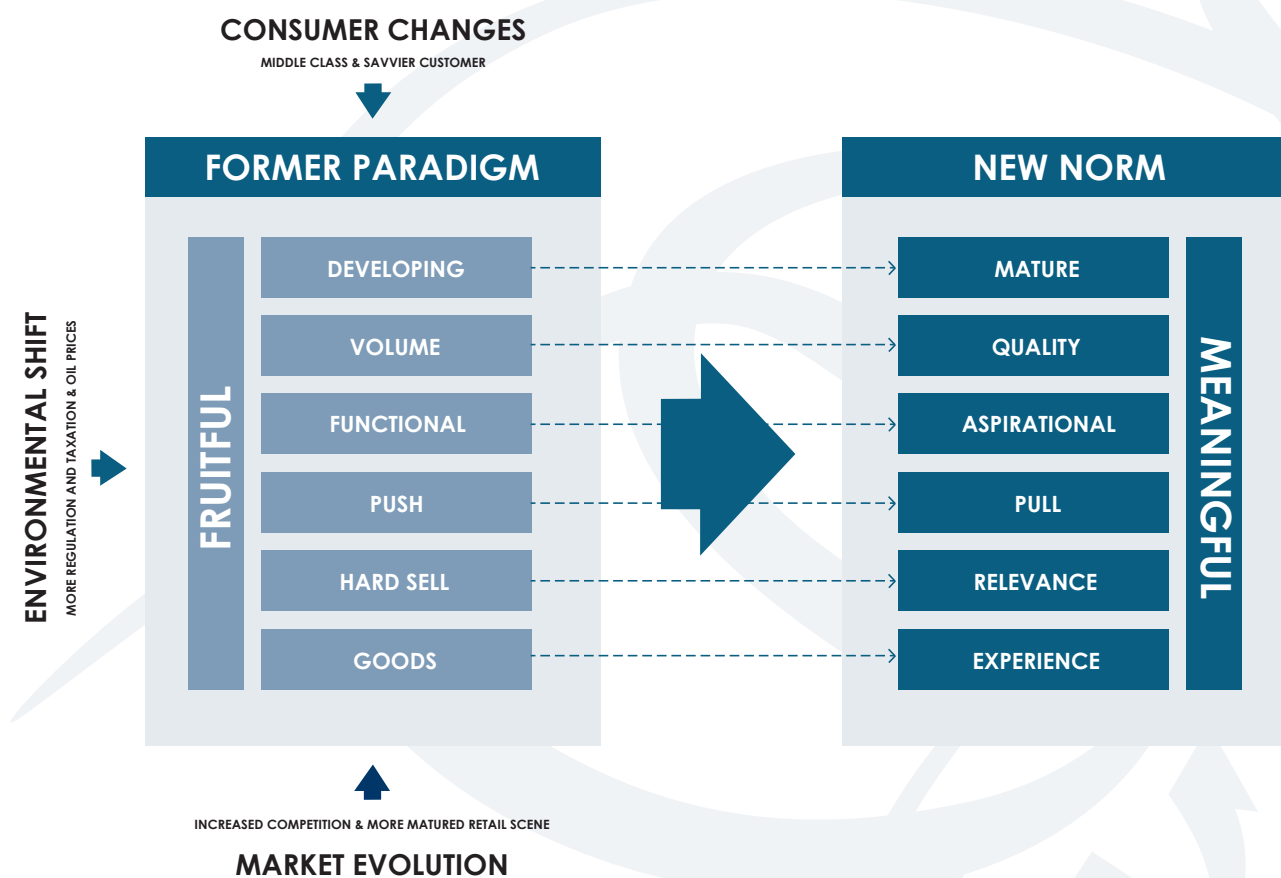
Today's local partner:

- Shares risks,
- Fosters operational efficiency to maintain profitability through economies of scale and "plug and play" shared services,
- Applies its networks, networking capabilities and expertise to help address the increased complexity of regulations and decision making. Brings its extensive customer expertise to impart customer-centric, bespoke product offers and services,
- Nurtures innovation to create unique and compelling shopping experiences that meet market needs,
- Is relevant and meaningful.



"The Gulf region has witnessed a period of abundance for the past 25 years with the building of incredible infrastructure and the development of the education of its young and vibrant population. It is now entering a new phase of maturity, of knowledge, of seriousness and of stronger governance. Despite the immediate geopolitical and economic challenges, this is a region of wealth and of steady growth. To be successful, we will have to be aspirational, relevant, meaningful and competitive, and adapt to the changes and to the New Norm."

PATRICK CHALHOUB - co-CEO Chalhoub Group



Source: The Chalhoub Group, February 2016⁴³

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