Neil Fiske and I wrote Trading Up in 2002, and the hardcover edition was published in the fall of 2003. It was a time when the United States was preparing for, and then beginning to conduct, the war in Iraq. One of my partners at The Boston Consulting Group called me during that period and asked, “Michael, do you really think this trading-up phenomenon is going to last? The world is in crisis.” My reply: “Trading up is one of the most powerful and durable economic phenomena of our times.” Even then, as the country entered this period of great change and disruption, we were certain that middle-market consumers in the United States would continue to devote a higher percentage of their disposable incomes than one might expect to one, two, or three categories of New Luxury goods.

As much as we believed in the trend, however, we were a little cautious about predicting what would happen over the next five years. In fact, we were in for a big surprise about how much the phenomenon (we didn’t call it a fad) would grow and how intense it would become. For example, we couldn’t predict the following:

- **The buoyancy of spending.** Consumers continue to spend on premium goods, no matter what is happening in the political, economic, or social environment.

- **The fact that trading up does not depend on increasing home values.** Many observers have argued that the trend is fueled largely by an unsustainable increase in housing prices. But even when housing valuations took a hit, trading up continued. Consumers have simply become more discriminating in their choices—trading up only for goods that mean the most to them.

- **Continued real income growth as a result of higher levels of education.** There is a direct correlation between education
and income. Consumers who trade up tend to be well educated and therefore command higher incomes and maintain higher spending levels. In addition, they save money even while “protecting” the most meaningful luxury items in their household budgets.

- The impact of younger and older consumers on trading up. Teenagers, who have as much as $600 a month to spend on whatever pleases them, and baby boomers, whose wealth is increasing and expenses are decreasing, are big trading-up consumers.

- The vigor with which women have driven and defined the market. This has occurred as a result of their rising education levels and earning power.

Underlying the appeal of the New Luxury are four emotional needs: to “take care of me,” to connect with others, to quest for adventure, and to seek an individual style. Trading up, as the world has come to understand, is not about wanton self-indulgence, materialist lust, or thoughtless consumerism. It’s about consumers buying a few products that make a difference in their lives.

**Trading Up Will Continue into the Future**

Leaders who opened their eyes to the trading-up trend when it was still in its infancy grew their companies, expanded whole categories, and helped create an explosion of trading-up behavior. In 2003 we estimated that the 23 categories of goods and services that constituted the heart of the New Luxury segment accounted for sales of $400 billion in the United States. We predicted that sales of these items would grow at a rate of about 15 percent per year and would reach $1 trillion by the end of the decade. We also developed the New Luxury 15 Index, a group of 15 publicly traded companies that produce premium goods in a variety of categories. These companies achieved an average annual sales growth of 19 percent from 2002 to 2003, significantly higher than the 3 percent growth in gross domestic product during that period. They also did well by their shareholders, achieving a median total shareholder return (TSR) of 26 percent for the three-year period from 2001 through 2003, in contrast to a 4 percent median annual TSR for the S&P 500.

These trends have continued. Wealth and discretionary income have steadily climbed. There are 10 million households in the United States that earn more than $100,000 each year. Trading-up spending accounted for about 21 percent of the $3.5 trillion that U.S. consumers spent in 2006—some $730 billion, up from $670 billion the year before—on key New Luxury categories, including homes and home renovation, transportation, food and beverages, travel and entertainment, personal services, dining out, home goods, apparel, and other fashion items. And the New Luxury segment is becoming a presence in many categories beyond the 23 we originally studied, such as financial services and health care.

But what about spending on these premium goods in 2008—in the shadow of a possible recession and a looming credit crunch? Consumers have read the news and are cautious. Yet, despite the sometimes hysterical tone of the media, they are taking the economy’s adjustments in stride and continuing to spend. After all, unemployment rates are still below 2 percent for middle- and upper-middle-income consumers, most of whom have stable cash incomes and a net worth of more than $140,000. The homeowners in this segment purchased their homes, on average, more than seven years ago and have one-to-one debt-to-equity ratios.

Middle- and upper-middle-income consumers will continue to trade up in those categories of goods that offer the technical, functional, and emotional benefits they seek. Although there may be less appetite (at the moment) for outsize houses, categories such as consumer electronics, exotic travel, food and wine, fashion accessories, and personal services will continue to attract New Luxury spenders.

We believe that New Luxury spending will be stable in 2008 and then regain its upward momentum in the years to come. The reason lies largely with increasing numbers of well-educated and well-employed women. Today women account for 57 percent of undergraduates and 59 percent of graduate students. They are entering the work force in droves and commanding the same wages as men their age. As a result, real household earnings will continue to increase over time. Look to women as the cure for the United States’ economic doldrums. They will spend—carefully and wisely, but they will spend.

**Trading Down Joins Trading Up**

Indeed, consumers are spending so carefully that they are scrutinizing every purchase. As we described in *Treasure Hunt* (the 2006 follow-up to *Trading Up*), consumers who trade up have no compunction about trading down—especially when the economy starts to look
a little shaky. For some categories of goods and services, they will go on a treasure hunt, searching for the highest value at the lowest price. Consequently, the trading-down market is also expanding, having risen from $1.1 trillion in 2005 to $1.2 trillion in 2006. It accounted for 33 percent of discretionary spending in 2006, up from 32 percent in 2005 and 31 percent in 2004.

The intensity of both trading-up and trading-down activity has led to another phenomenon, which we call death in the middle. Discretionary spending on traditional, middle-market products and services, such as jeans and cars, is spiraling downward. In 2004 such products accounted for 51 percent of consumer spending. That figure dropped to 48 percent in 2005 and 46 percent in 2006.

But those companies that have escaped the middle and been successful at creating New Luxury goods have continued to outperform their competitors. The luxury-goods company Coach, for example, had a market value of about $2 billion when we first began tracking it about five years ago. Coach executed a trading-up strategy with incredible boldness, vision, and relentlessness, and has become one of the iconic brands of New Luxury and masstige. Today, with $2 billion in revenues and a 77 percent gross margin, the company has a market valuation of approximately $12 billion.

Trading Up in Markets Outside the United States

Trading up and treasure hunting are not limited to the United States. They are just as relevant and powerful in Australia, Canada, China, Europe, India, and Japan. The sociodemographic forces that drive these trends in the United States operate similarly in other regions, with only minor differences of rate and degree. And the size of the trading-up segment in these countries is about the same as it is in the United States.

In 2007 we conducted a large-scale, quantitative survey of consumers in China, supplemented by in-depth interviews with women and men throughout the country. Consumers there have experienced tremendous growth in personal income and are beginning to spend on premium goods and services. The greatest opportunity for consumer businesses in China is in trading-up goods, particularly in apparel, consumer electronics, food and beverages, footwear, and personal care. As Chinese consumers have become more and more focused on product quality and safety, the value of well-known and trusted brands has grown dramatically.\(^1\)

Around the world, companies are looking for the New Luxury sweet spot that will enable them to move off of the traditional demand curve and achieve high margins and high volumes at the same time.

A Strategy and a Set of Practices

How do the companies that are benefiting from the trading-up phenomenon accomplish their goals?

We have been fortunate to work with many great companies as they turned their attention away from the middle and focused instead on trading up. In the process, we helped them create several billion dollars’ worth of premium products and services for trading-up consumers. We have seen entrepreneurs who demonstrated energy and imagination become rich, successful, and highly influential. Large incumbents, too, found they could energize themselves by creating goods that consumers who trade up eagerly want to buy.

Leaders of companies around the world have adopted our ideas, adapting them to their industries and markets. They have also developed their own systematic management processes—based on a hierarchy of technical, functional, and emotional benefits—for creating premium goods and matching them to consumers’ interests. These leaders see trading up as a strategy and consistently follow a manageable set of best practices:

- They deliver genuine technical, functional, and emotional benefits in every product or service they offer
- They target their consumers precisely, ignoring traditional market segmentations and looking for common attitudes, spending patterns, and habits
- They create appealing brand identities, rich graphics, stunning retail presentations, and engaging shopping experiences
- They produce a stream of innovations
- They invest in better raw materials and imaginative design to gain a return on the sell side
- They create product apostles before and during the launch of their goods and services; these apostles act

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\(^1\) For more about this survey, see *Winning the Hearts and Minds of China’s Consumers*, BCG Focus, September 2007.
as a compass for identifying how the market truly judges their offerings

Looking Forward

Now, with five years of longitudinal data under our belts, we are more convinced than ever that the trading-up phenomenon is a fundamental, ubiquitous, and long-lasting aspect of our consumer-driven global economy.

Trading up is driven by middle-class consumers who are educated, discerning, and committed to knowing more about the goods and services they use. These consumers are relatively affluent, earning more than $50,000 per year. They balance their budgets and trade down in more categories than they trade up in. They use goods to alleviate the stresses of modern life and to realize their aspirations. For the most part, however, they do not fool themselves into thinking that material goods will solve their deepest problems or take the place of essential needs, such as health and human connection.

We continue to believe that trading up is a positive phenomenon. The presence of New Luxury goods benefits people at all income levels. And in a polarized market, low-cost goods become better and more available. Pressure from the most affluent consumers stimulates and accelerates innovation, particularly at the high end; innovation then cascades down to lower-priced products and becomes more affordable and available to more people.

Trading up is a positive force, it’s global, and it’s here to stay. For business leaders, it represents a competitive threat. But for others, it’s an opportunity to grow their businesses, transform their categories, and connect with consumers worldwide. The best is yet to come.

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