

## RESEARCH PAPERS

### Luxury markets and premium pricing

**Ian Yeoman\* and Una McMahon-Beattie**

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\*VisitScotland, Ocean Point One, 94 Ocean Drive, Edinburgh EH6 6JH, UK  
Tel: +44 (0)131 332 2388; Fax: +44 (0)131 472 2223; E-mail: ian.yeoman@visitscotland.com

*Ian Yeoman is Scenario Planner at VisitScotland, the national tourism organisation, where he is responsible for economic forecasting, scenario construction and trends analysis. He is the founding Editor of the Journal of Revenue & Pricing Management and co-editor of six books in the fields of tourism management. His latest book Tomorrow's Tourist is due for publication in 2006. He has a Ph.D in Management Science from Napier University, Edinburgh and was recently appointed to the World Tourism Organisation expert panel.*

*Una McMahon-Beattie is a lecturer in marketing at the University of Ulster. Her research interests include revenue management, pricing and consumer trust. She has published widely in journals, books and conferences in these areas in the UK and internationally. She is Practice Papers Editor of the Journal of Revenue and Pricing Management.*

#### ABSTRACT

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*The world is getting richer and the consumer has more real disposable income. This phenomenon is being repeated all over the world, whether in China or the USA. This means that consumers are trading up for products that meet their aspira-*

*tion needs and trading down for products which they perceive as commodities. This paper addresses the issue of the luxurification of society and how organisations are using premium pricing effectively through a series of case studies.*

#### INTRODUCTION

Many readers of the *Journal of Revenue and Pricing Management* may think that, ever since the arrival of low-cost carriers and the Internet, revenue management has been in crisis. For example, the airlines have witnessed falling revenues, and this has resulted in many traditional carriers filing for bankruptcy. In fact, air travel has actually become a commodity where the pressure is for prices to fall rather than rise. Economists call this disinflation. Customers are no longer willing to accept price rises for air travel and this, coupled with a market characterised by openness and a lot of competition, has resulted in falling revenues.

The opposite to the world of disinflation is affluence and luxury. Here, prices are rising rather than falling, as they play to consumers' aspirations. Silverstein *et al.* (2005) tell the story of how social and economic forces have fuelled the luxury phenomenon in the USA. The consumer today has more disposal income than at any other time in history. This is due to low interest rates, rising house prices and associated equity, low inflation, falling commodity

prices and low unemployment. It means that consumers have more aspirations and will spend more money on things that make them feel good. Fundamentally, they are trading up. To the marketer, this signals opportunities for premium pricing in luxury markets. Premium pricing and luxury markets, however, have received little attention in the literature, and therefore they are the focus of this paper.

## LUXURY

### A theory of luxury

When Marie Antoinette supposedly said 'let them eat cake', she was seen as a luxury junkie whose out-of-control spending grated on the poor and unfortunate French people. But today, cake has become one of the favourite luxury foods. A revolution has taken place where individuals in the world have got richer. Luxury is no longer the embrace of the kings and queens of France but the mass marketing phenomenon of everyday life. Simply put, luxury has become luxurification of the commonplace (Twitchell, 2001; Berry, 1994). The word luxury is derived from *luxus*, meaning sensuality, splendour, pomp, and its derivative *luxuria*, means extravagance, riot etc. The rise of the luxury in the Western society is associated with increasing affluence and consumption. It is a phenomenon that has been creeping up in society for hundreds of years. At the turn of the 20th century, it was Thorsten Veblen (1899) who coined the term 'conspicuous consumption' in his theory of the leisure class. Veblen's argument is based upon the belief that, as wealth spreads, what drives consumers' behaviour is increasingly neither subsistence nor comfort but the 'attainment of esteem and envy of fellow men'. Because male wage earners are too circumspect to indulge themselves, they deposit consumption on surrogates. Vicarious ostentation is observed in Victorian men who encour-

aged their wives and daughters to wear complicated trappings of wealth. Veblen thought that the purpose of acquisition was public consumption of esteem, status and anxiety displayed by materialism. What Veblen termed as conspicuous consumption were the trophies such as salves or property where people would show off their wealth. The ideas contained in Veblen's study of luxury and conspicuous consumption were developed in the works of John Galbraith, such as *The Affluent Society* (1958) and Vance Packard's *The Hidden Persuaders* (1957), *The Status Seekers* (1962) and *The Pyramid Climbers* (1959). Galbraith's work moved us from an understanding of luxury based upon royalty and those that were born into money to those that made their money, such as the Carnegies and steel, Ford with the motor car or Hughes with aircraft. Further works by Schor at Harvard University (1991, 1998) explored how Middle America was becoming more affluent. Luxury goods were no longer luxury goods but everyday household goods (Silverstein *et al.*, 2005).

The concept of luxury is incredibly fluid, and changes dramatically across time and culture. In the past, it was associated with champagne, caviar, designer clothes and sports cars. Nowadays, with increased affluence, luxury is a blurred genre which is no longer the preserve of the elite. More and more consumers have traded up as the old values of tradition and nobility have become less important. People are enjoying much more material comfort in comparison with previous generations, resulting in a trend of a cultural shift for personal fulfilment and aspiration through experience. Therefore, it could be argued that luxury is increasingly about experience and authenticity (Yeoman *et al.*, 2005), rather than monetary value. This is not to say that luxury is about status, but luxury is more than monetary value. Indeed, they run side by side. This focus on aspiration and

experience means increasing emphasis on personal transformation through, for example, well-being and travel. It means that consumers want to improve their lives. This is what Danziger (2005), Israel (2003) and Gambler (1997) identify as the feminisation of luxury, where luxury has moved on from its male trophies and status symbols towards experience and indulgence. This is perhaps attributed to women's increasing buying power in society, which is driving luxury markets such as well-being, clothes and tourism. Therefore, luxury is becoming a lot more difficult to define, as the language has changed. Luxury today is neither a necessity nor necessarily expensive. It can be mass market, not traditional, but personal, authentic and experiential. The old world luxury of consumption and elitism, however, still prevails.

### **Luxurification in society**

As luxurification becomes commonplace, owing to the rise in disposable income (Twitchell, 2001) of the middle classes, consumers start to trade up. Silverstein *et al.*'s (2003, 2005) work on trading up explores the US phenomenon of middle market, middle income earners who are willing to pay premium prices for products and services that possess higher levels of quality, taste and aspiration than other goods in the same category. These 'new luxury' goods have flouted conventional wisdom that suggests the higher the price the lower the volume. These new luxury goods sell at higher prices and at higher volumes than traditional luxury goods. Silverstein *et al.* highlight how the middle-market consumer selectively trades up to better products and services and trades down in others to pay for his or her premium purchases. This is a person who travels with a budget carrier but stays in a five-star hotel. Much of this change on the demand side has come about owing to a

rise in real incomes and home equity, the cash windfall delivered by mass retailers, the changing role of women and the family structure, the rise in divorce, the increasing worldliness and sophistication of the US consumer and the increased focus on emotions and growing cultural permission to spend. All these have been the drivers of luxury.

On the supply side, the impact of the role of the entrepreneur, shifts in the dynamics of retailing and the increased access to flexible supply-chain networks and global resources has been witnessed. As consumers trade up, they spend 20–200 per cent above the norm for the product or the service. Consumers have woken up to appreciate better-quality wines or how they have a desire for far away exotic holidays. Goods and services have traded up, and this can be seen in such products as cosmetics, sandwiches, white goods and pet foods. The basis of trading up is access and aspiration. Examples would include the Mercedes-Benz C-class, which constituted the affordable version of a product that has traditionally been bought only by more wealthy consumers. Such goods offer an emotional engagement, whether it is premium vodka or an environmentally sensitive cosmetic range, such as Aveda.

It is also interesting how consumers are trading up to aspirational new luxury goods and trading down to products and services that are less important to them. This type of product and service mixing (disharmony of consumption) is occurring in retail as consumers shop at Wal-Mart or Asda, but drive a Mercedes. The analogy in the tourism sector is apparent in the use of budget air travel and the purchase of quality accommodation and food in the host destination.

In terms of consumer drivers, the demand for luxury is affected by demographics and cultural shifts. In addition, the degree and amount of disposable income

has increased significantly. This has been catalysed by the growth in consumer credit and the contribution to consumer wealth made by large discount retailers. In recent years, they have reduced the costs of living substantially for middle-market consumers. Furthermore, the increasingly active role of female consumers has helped catalyse luxury demand at a range of levels. The fact that couples are getting married later in life (if at all) and are having fewer children (often later in life) means that the amount of disposable income for luxuries has grown substantially. The increasing number of singles and the growing divorce rate means that the amount of money spent on the individual has increased. Such expenditure is often used to help rebuild lives, confidence and provide a panacea for emotional distress. In such cases, the propensity of the consumer to spend on luxury products and services will increase.

A further influence on the luxury spend profile is the relative sophistication of the consumer. In the UK and the USA, the middle market consumer is increasingly better educated, better travelled, more adventurous and more discerning. The pressure to increase the number of graduates in the UK workforce will continue to drive the growth of the sophisticated consumer.

Other key impacts include the availability of luxury products and services, not just in traditional retail contexts, but also in electronic format via the internet. Travel buying, data on destinations and the continual emergence of new locations means that luxury availability has increased significantly. Furthermore, the disinflation of travel supply and the continued downward pressure on prices has served to 'democratise' travel, and in some senses this has democratised 'luxury'. Previously exclusive destinations and products, from cruises to resorts, have become more widely available, and their relative badge of exclusivity has become more mainstream.

### Drivers of luxury

- Discretionary income has reshaped household incomes since the 1980s. The standard of living has doubled, and this is expected to grow further (Cornish, 2003). Driving this discretionary income has been the rise of spending on leisure and the decline of spending on housing. With low interest rates, cheap credit and low inflation, consumers have spent that money on themselves, therefore consumers have upgraded.
- Capital growth rather than income growth has been fuelled by property booms across the world. Especially strong growth in the UK, USA, Sweden, Spain and Australia has been fuelled by rising house prices (OECD, 2004). There has also been a rise in the popularity of equity release schemes, where consumers take money out of their properties to fund consumer spending. Record numbers of second-home owners, equity release schemes in the UK and record levels of wealth have driven luxury spending (Stokes, 2005).
- With low inflation rates, consumers are reaping the benefit of a low-cost world. Consumers will think nothing of staying in a five-star hotel in a far away destination, but will travel as cheaply as possible owing to the rise of budget carriers such as easyJet and SouthWest Airlines (Silverstein *et al.*, 2005; Yeoman, 2004).
- In 1992, 35 per cent of UK consumers had no qualifications whatsoever, compared with 20 per cent today. Furthermore, across the world, levels of educational attainment are increasing, especially in higher education. In 2004, 2,176,000 of all school leavers in England and Wales went into higher education compared with 721,000 in 1970 (Yeoman, 2004). Education is a driver of luxury, as the consumer is

more discerning and more liberal, according to research by the Future Foundation (Cornish, 2003).

- Increased affluence and educational attainment mean that the consumer is more 'travelled' and experienced compared with previous generations (Willmott and Nelson, 2003). Changing gender roles, a decline in the importance of religion, sexual freedom and a multicultural society mean that society is more liberal and cosmopolitan in its outlook. This opens opportunities for new product developments, as greater tolerance increases people's desire for choice and variety. As people experience new worlds, they re-create that world in their daily lives. This trend accounts for the increase in the variety of multicultural foodstuffs and African furniture.
- Consumers are more aspirational, as they are demanding more of themselves and their lifestyles, particularly with attitudes towards leisure times and holidays. Personal development is becoming increasingly important, with luxury products and services responding to the desire for experiences and self-fulfilment. Research by the Future Foundation shows that, in 1980, the total expenditure on enrichment activities and experiences was £46bn (2002 prices) and, by 2002, this had risen to £95bn (Cornish, 2003).
- There has been a cultural shift towards individualism and the willingness to try new things. This has resulted in a shift away from conformity, which in turn has resulted in an increase in expenditure on a wider range of products and experiences. According to Stevens (2005), this movement towards individualism is seen in the increase in sporting activity, where consumers are trying a range of sports rather than concentrating on one particular sport.
- A higher level of educational attainment

along with a society that is bound in knowledge and creativity means a growth in the cultural sector and the rising importance of cultural capital (Willmott and Nelson, 2003). This reflects not only the role of cultural capital as a means of differentiation and advantage but also the related and growing interest in experiences and fulfilment. Therefore, according to Eurostat, consumer spending on culture has been growing for the last 50 years. The consumer is spending and taking more trips to the theatre, galleries and libraries. But cultural capital is more than 'highbrow' activities. It is the value and interest in, for example, Italian cuisine or being a Greenpeace activist or just watching 'Big Brother'. This combination of highbrow and lowbrow activities is now called 'no-brow', as culture is realised as capital and its role in everyday language and currency is witnessed.

- Consumers increasingly feel under time pressure, and families are particularly affected by this. As leisure time becomes more important, the luxury of a time oasis becomes more important. Therefore, households are trying to create time, resulting in an increase in the amount of personal service such as the personal shopper, shirt ironing services and dog walking (Scase, 2000).

## **CASE STUDIES OF LUXURY MARKETS AND PREMIUM PRICING**

### **The luxury destination: Dubai**

According to Mintel (2004), Dubai has succeeded in pitching itself as an all-year-round luxury getaway, in which extravagance is the norm. It is Crown Prince Sheikh Mohammed Al Maktoum who is determined to position Dubai as the financial and tourism centre of the Middle East before the oil wells run dry. To facilitate

this, laws have been relaxed to allow foreigners both to buy property and to establish residency. Iconic stars such as David and Victoria Beckham ('Posh and Becks') are buying property at the Jumeirah Beach Resort, a man-made island oozing with luxury. Thirty years ago, there was nothing in Dubai but a creek, a Sheikh's palace and a bad reputation as the smuggling capital of the world. Today, Dubai boasts 272 hotels with 30,000 rooms and 30 shopping malls. As a city state, the extravagances of luxury are everywhere, including The Dubai World Cup, which is the richest horse racing event in the world with a \$6m prize (BBC, 2004). But Dubai is not a destination just for the super rich; luxury is for the masses. It has become affordable for the middle classes of the world, whether as a stopover point, a short break or a two-week holiday. Dubai is a luxury destination for all travellers, not just for the Beckhams.

#### **Authenticity: RF Hotels**

RF Hotels is a chain of luxury hotels that represents the best traditions and old-fashionedness of service and history. They represent famous-name hotels that offer first-class service, such as the Balmoral Hotel, Edinburgh, and the Hotel Savoy, Florence. At the forefront of these hotels is Sir Rocco Forte, a hotel entrepreneur whose name is synonymous with first class luxury. No two properties are the same, as these famous hotels are brands within themselves. Each hotel is rich in history, nationality and location. They represent an authentic experience of character, quality accommodation, fine food and the highest level of service, which is individually customised for each guest (Schmenner, 1995). The detail of each hotel means furniture and fabrics that match an authentic five-star elegance of individualism in which ornaments and personal touches create a welcoming and indulgent atmosphere. Restaurants are award winning, where top

chefs create an individual flair. Hotel rooms are of the highest comfort, with all the latest technologies. Indulgence and escapism is found in the latest spa treatments. Authenticity is the aspiration (Yeoman *et al.*, 2005) that is not comprised — this is the brand essence that is protected by a premium price. Access is restricted to those that can afford it.

#### **Sexuality: Victoria's Secret**

Women as luxury earners are very different from the housewife consumers of the 1950s (Silverstein *et al.*, 2003), as the majority of women in the Western world now participate in the workforce. For instance, 60 per cent of all women aged 16–64 work, either full time or part time. Seventy-six per cent of women aged between 25 and 44 (the peak of earning) work. Not only are more women working, they are earning higher salaries than ever before. Combined with the fact that women are getting married later, there is a cohort of young, single women that are spenders. This cohort is highly educated compared with other cohorts (Future Foundation, 2005), is more liberal in attitudes to sex and is dating more. The average woman now has ten sexual partners before marriage compared with half that number in the 1970s. Men and women are even more demanding and explicit about their sexual behaviour, attitudes and expectations. The combination of these facts has resulted in changes in the UK high street. Anne Summers, once seen as a seedy lingerie and sex toys concept mainly sold at parties, is now in the high street of most major towns in the UK (Storr, 2003). Even Selfridges, a leading upmarket departmental store in London, is selling upmarket diamond clustered vibrators!

Victoria's Secret is an upmarket brand of lingerie based on the assumption that American women want to wear lingerie rather than underwear. It is positioned on the proposition that European women's

attitude about lingerie is different from that of American women. There is a void in the American market between high aspiration and high volume brands. Lingerie in the USA has been seen as stale and not sexy. Therefore, on the basis of these observations, Leslie Wexner developed a vision to create beautiful, European-inspired products, made of the best fabrics, in the best way and at a price that was affordable. At the core of the Victoria's Secret is a story of sexiness, good taste, European heritage, sophistication and femininity which is the brand. Sales of Victoria's Secret lingerie in USA in 2004 reached \$2.4bn, based upon the concepts of aspiration, liberalness, sex and the power of women as luxury spenders. Victoria's Secret is an aspiration of European design for the American consumer. Sexuality is the added value which the consumer pays extra for. That consumer is female with greater affluence and wants to wear a quality product for 'me'.

#### **Design and nostalgia: The Mini**

In 2001, the new Mini Cooper was launched. The car was in fact a new car. It included a six speed, 163 horsepower engine, a six-speaker CD, air conditioning and airbags. The Mini was launched in the USA with the theme line 'Live me, dress me, protect me, drive me' (Silvestein *et al.*, 2005). The Mini is taking the USA by storm. Take the story of Mini driver Candace Sleeman, from New Jersey (BBC, 2005):

'People I meet are fascinated by it. They're always asking if they can sit in it, so of course I let them. A couple of times I've been at the supermarket, and burly men have stopped, rolled down their windows and asked if I was going to put my car in the "trolley return" section. They view them as Mr Bean cars, but I think generally people love them here.'

The Mini is a well-designed car that is fun to drive and looks good. It has aspiration, history and nostalgia. The iconic film *The Italian Job*, starring Michael Caine, immortalises the car, giving social cachet, therefore allowing BMW to sell the car at a premium price.

#### **Health and well-being: The mineral water sommelier, Ritz Carlton Hotel, New York**

Just imagine for a moment Samantha from *Sex in the City* ordering a lunch at the Ritz Carlton Hotel, but instead of seeking advice from the sommelier on which wine she should have, she decides to choose Glen-eagles Spring Water, a light and refreshing water from Scotland which is naturally low in salts and minerals. This is a perfect accompaniment for her *darne* of chilli sea bass. The water sommeliers at the Ritz Carlton are there to advise diners on water's clarity, taste, brightness and parity with food. In the USA, a staggering \$6.5bn is spent on bottled mineral water each year. As people turn away from carbonated drinks such as Coke and 7-Up and drink less alcohol, mineral water sales are rising, based on the trend of well-being, health and purity. Restaurants are offering professional advice to help diners choose between Perrier, Highland Spring, Ty Nant, Pellegrino or Evian. Filip Wretman, the water sommelier at the Ritz Carlton, will suggest a range of still and sparkling waters to accompany cheeses, spicy dishes or sweet offerings. He meets the aspirations of the customers, offering expert advice with a product that offers purity. By providing such a service, the Ritz Carlton can offer a premium price and create added value for 'water'.

#### **Fairtrade: Paying a premium for ethical consumption**

Progresso coffee bars are a joint venture between Oxfam (a leading charity for the third world), farming cooperatives and

trust funds, paying a fair price for coffee. Progresso opened their first branch in Covent Garden, London, in January 2005. The sales in the first financial quarter exceeded all expectations. The principle is based upon fair trading, where consumers pay a premium for ethical consumption. Fairtrade is a mainstream trend nowadays. With leading UK supermarkets like Tesco operating their own fair-trade brands on orange juice, roses, coffee and chocolate. The Fairtrade foundation, an organisation that promotes better working conditions and trade terms for developing world producers, says annual fair trade sales have hit the £100m mark. Growth in the Fairtrade label since it was launched in 1995 has stood at between 40 and 90 per cent a year, expanding from one brand of coffee to 250 foods, including fruit, juices, vegetables, snacks, wine, tea, sugar, honey and nuts. Britain is the second largest market after Switzerland, with the concept expanding across the world. The history of Fairtrade is found in aid organisations wanting to promote fair trade by enabling producers to sell their handicrafts directly to Western consumers, often in their charity shops. While the schemes pulled some families out of poverty, Fairtrade recognised the need for programmes to include a greater number of goods, be embraced by commercial manufacturers and to bring fair trade into the supermarkets where most people shop. Fairtrade also extends into fashion. For example, People Tree is a fair-trade fashion company which works with 70 fair-trade groups in 20 developing countries to showcase its lines. The company pays its suppliers 20–30 per cent more than they receive without fair trade deals and guarantees. Fair trade is now mainstream with UK. The supermarket chain Co-op was the first supermarket to take substantial quantities of fair trade, and Café Direct is now Britain's sixth biggest coffee company. Even the Youth Hostel Association and the

Salvation Army are switching to fair-trade food (Jones, 2004). Fairtrade appeals to consumers' consciences about ethical trading by using the Fairtrade kite mark.

### **KEY FACTORS IN PREMIUM PRICING AND BRANDING**

Luxury has a psychological association with premium pricing. Allsop (2004) states that premium value is price and quality plus the intangibles of style, uniqueness, occasion and experience. Here, goods and services such as home furnishings, holiday accommodation, food for a dinner party, restaurants and home electronics have a high perception of value. But goods such as aeroplane tickets and electricity have no added value. Therefore, the implication for marketing is that consumers are willing to pay more for certain goods and not for others. To the marketer, it means creating a brand equity or value for which the consumer is willing to pay extra. Marketers view luxury as the main factor differentiating a brand in a product category, as a central driver of consumer preference and usage (Vigneron and Johnson, 2004). In order to understand the 'extra value', it is important for marketers or pricing managers to identify the key factors from a consumer perspective. All the case studies mentioned so far rely on these factors (Silverstein *et al.*, 2005). The factors are:

- Never underestimate the customer, as consumers have a desire, interest, intelligence and capability to trade up. They are willing to pay for that extra value, time or aspiration.
- Consumers will shatter the price–volume demand curve. Consumers are not looking for an incremental improvement. Pricing managers must go for premium prices and higher volume, not being scared to take a risk.
- Always create a ladder of genuine benefits rather than confusing the

consumer with meaningless innovations. This means technical and functional benefits that result in emotional advantage for the consumer. Additionally, do not pretend to be something you are not.

- Escalate innovation, elevate quality and deliver a flawless experience. The market for luxury is growing, but it is unstable. This is because the market does not stand still as new competitors enter. It is a constant battle to keep ahead, as there will always be a lower-priced alternative around the corner.
- Extend the price range and positioning of the brand. It is important to create, define and maintain a distinct character and meaning for each product offering at every level in the value chain. This way, there is a ten-fold difference between the lowest and highest price points. Luxury means driving aspiration and accessibility.
- Remember to customise value chains to deliver benefits. Create wealth and quality in the chain and ensure that this is managed.
- Use influence marketing and seed success through brand apostles. In a world where advertising is under pressure as a result of choice and trust, put the emphasis on core customers who will deliver a luxury product capital.
- Continually attack a product like an outsider. Think as the competition or a maverick. The competition will beat you if you do not.

## CONCLUSIONS

The purpose of this paper has been to highlight the often neglected area of premium pricing and luxury markets. As consumers' incomes across the world rise, their aspirations grow. While air travel has become a commodity, many experiences and products have seen the benefit of consumers

trading up. The rising middle classes of the world are now experiencing luxury, the like of which their forefathers would have never imagined. No longer is it uncommon to take several holidays a year, to have a second home or dine in an award-winning restaurant. Therefore, the challenge for the future is to enhance particular strategies for premium pricing. It is hoped that this paper has contributed to the debate.

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