PALGRAVE ADVANCES IN LUXURY
NEW LUXURY MANAGEMENT
Creating and Managing Sustainable Value Across the Organization
Edited by
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# Palgrave Advances in Luxury

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The field of luxury studies increasingly encompasses a variety of perspectives not just limited to marketing and brand management. In recent times, a host of novel and topical issues on luxury such as sustainability, counterfeiting, emulation and consumption trends have gained prominence which draw on the fields of entrepreneurship, sociology, psychology and operations. Examining international trends from China, Asia, Europe, North America and the MENA region, *Palgrave Advances in Luxury* is the first series dedicated to this complex issue. Including multiple perspectives whilst being very much grounded in business, its aim is to offer an integrated picture of the management environment in which luxury operates. It explores the newer debates relating to luxury consumption such as the signals used in expressing luxury, the socially divisive nature of luxury and the socio-economic segmentation that it brings. Filling a significant gap in our knowledge of this field, the series will help readers comprehend the significant management challenges unique to this construct.

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Editors

# New Luxury Management

## Creating and Managing Sustainable Value Across the Organization

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# Introduction

Luxury, as well as luxury markets and luxury management, has received a growing interest in the past decade, both from researchers and practitioners. This has generated a large amount of literature on these subjects, covering various aspects and offering different perspectives and interpretations. The luxury goods industry still remains a growing one, despite the big changes that have taken place in the last few years at economic, technological and social level, bringing some increasing turbulence and calling for strategic readjustments among the industry key players. The willingness of consultants and researchers to understand the reasons beneath this almost endless pattern of growth partially explains the interest in this domain. On the other hand, companies and brands outside the traditional luxury industries progressively adopted practices and approaches that generated in the core of luxury goods, from limited series to customization services, in an effort to increase the overall customer experience and differentiate from a growing number of me-too players. This second aspect accounts for the need of a deeper understanding of the processes, assets (both tangible and intangible) and competencies that allow luxury companies to create value for their very particular clientele in order to assess their replication in different industries and price segments.

In this sense, this book presents the different aspects that make luxury companies a sort of unique combination of competencies and assets and

provides a "luxury specific" understanding of how value is created in the luxury markets. In order to achieve these goals, the authors devoted their attention to: (i) the uniqueness and specificities that make luxury companies so different from the ones belonging to other industries; (ii) the characteristics of their most valuable assets; and (iii) the key processes in the value chain of luxury companies and how they are managed. This text might rely upon a unique combination of authors (coming from French and Italian leading business schools with strong backgrounds in luxury) who, though being experts in their own disciplinary field, share a common vision of the luxury value creation processes and assets that have been established through their involvement as faculty members of IMLUX Master Programme developed by Mip, Politecnico di Milano and Neoma Business School, and supported by companies such as Gucci and Champagne Taittinger.

This common vision involves the description of "the new luxury", that is, a contemporary and comprehensive description of what creates value in luxury markets through a comprehensive view of: (i) the value chain, from concept to market; (ii) the unique combination of skills and assets that make luxury products and service so special to the eyes of customers; and (iii) the patterns and strategies for growth adopted by luxury companies. The authors argue that the main characteristics of "luxury" are linked to specific resources and competencies found throughout the value chain within companies operating in the luxury sector and in their value network of stakeholders. Among the key resources for luxury value creation a unique blend of knowhow and skills and strong and deeply evocative brand narratives plays a crucial role and accounts for luxury-specific managerial practices. This mix of assets and competencies is operationalized in key processes that involve the creative one as well as supply chain management, retail and communication aspects that might adapt to the dynamic and evolving global marketplace, changing consumer behaviours and new technologies. The way luxury companies manage their growth results in their uniqueness in terms of assets and key processes and shows peculiar aspects. These aspects contribute to the definition of organic growth options through exploitation of assets or mergers and acquisitions that call for a specific organizational culture to preserve assets after mergers are over.

This book therefore presents an interdisciplinary approach for the successful creation and management of value across the organisation: leadership, human resources, financial, strategic, marketing, economic and legal perspectives are addressed in order to understand each process in depth and all aspects related to value creation and its management. Moving from the creative process to the distribution of luxury products and services, the book provides an integrated approach to the full value chain. This includes functional processes such as design, operations, SCM, on and off line communications and retail management from a disciplinary and academic perspective. Moreover, it provides a comprehensive approach to the management and evaluation of luxury intangible assets.

This book covers both strategic and functional aspects of luxury management providing a comprehensive yet coherent and integrated vision on the subject. The book is divided into four parts that encompass: (i) an operational definition of luxury and the traits of uniqueness of luxury companies compared to the ones that operate in other sectors; (ii) the key intangible assets and competencies that support luxury value creation; (iii) the management of the key processes of value creation for luxury firms (product and collection design, operations and supply chain management, service and customer experience design, store management, integrated marketing communication); and (iv) growth issues in luxury companies (evolution and dynamics of business models, integration of competencies post M&As, selecting and empowering people for company growth, international retail strategies and operations for sustainable growth).

This book is targeted at master level students, both at MSc and MBA level, willing to gain a global overview of the key aspects that define the process of value creation in luxury industries as well as practitioners looking for an up-dated comprehensive description of the main aspects and characteristics of luxury companies and their growth patterns and strategies under a unique and common perspective.

Fabrizio Maria Pini
Emmanuelle Rigaud-Lacresse

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# 1

# Luxury as a Construct: An Evolutionary Perspective

Alessandro Brun

When dealing with luxury, one of the most critical aspects is the fact that the interpretation of what is luxury and what is not luxury is typically judgemental, somehow blurred and constantly evolving. As a consequence, it is of the utmost importance to give a definition and provide boundaries to the concept of luxury, following a structured and rigorous approach, before beginning a dissertation on how to manage it within companies.

In the last decade, the number of papers and books dealing with luxury—either expressly or as an ancillary topic—significantly increased following the exceptional growth experienced by the luxury industry from the turn of the century to the closing figures of 2015. The luxury industry encompasses companies producing and selling such goods as cars, yachts, wines and spirits, clothing, leather goods, shoes, accessories, watches, jewellery, cosmetics and perfumes, but also services including luxury hospitality and spas. Globally, such industry is estimated to account for a

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boasting €1 trillion. While barely two decades ago, single-brand, family-owned companies accounted for more than 50 % of personal luxury goods sales, nowadays the industry is largely dominated by multi-brand, publicly owned groups.

The dazzling aura surrounding the luxury business continues to attract manufacturers, managers, investors and aspiring businesspeople with the promise of high margins, although it is not clear that this market sector will continue to be golden. In addition to determining the reasons for the growth of this market and its sustainability, a key issue facing academic researchers and practitioners is establishing what the term luxury refers to. A substantial body of literature on the topic has struggled to define the concept.

Although this issue might seem trivial, there seldom is agreement regarding the concept of luxury. Some individuals might define luxury as referring to products containing precious materials, while others might associate it with the lifestyle of a privileged elite. Some may consider luxury to refer to any high-priced object, while others might perceive it as referring to any product that costs at least two or three times as much as a cheaper version. Some perhaps concentrate on luxury goods; others might believe that the only true luxury is time. Some might associate the concept of luxury with positive feelings, while those who consider luxury to be unnecessary may perceive the word to have negative connotations. In addition, the perceived utility and cost of a product are not the only features that have been used to characterize a luxury product. A luxury product is also often intended both to display wealth and as a vehicle for self-expression. The motivation for purchasing luxury products, such as self-indulgence or status seeking, may also vary.

Furthermore, defining luxury is not merely a philosophical or academic exercise. In the wake of the market success of famous luxury fashion brands, self-proclaimed luxury companies are currently thriving worldwide. Both consumers and manufacturers should understand the phenomenon, because the proliferation of luxury products and brands might undermine the concept of luxury:

- On the one hand, consumers confused by the use of the word luxury for a wide range of goods and services might progressively lose the ability to recognize the characteristics that justify the premium price of a

luxury good or service, increasing the risk of dissatisfaction with the products they purchase.
- On the other hand, manufacturers who have noticed that the return is much higher when premium prices are charged for slightly above-average products might be less motivated to engage in a quest for excellence, leading to a slow but steady decline in product quality.

Given the confusion that surrounds—as every myth—the myth of "luxury", the goal of this introductory chapter is therefore to shed some clarifying light on three important aspects, by:

- sketching an outline of the historical evolution of the concept of luxury;
- acknowledging the subjective nature of the concept of luxury and therefore presenting a list (which cannot be but incomplete) of answers to the question "what makes it luxury?" (the list is qualitative and based on the judgemental perspective of some experts);
- suggesting that luxury goods be distinguished from other goods through the presence of critical success factors (CSF) and identifying different dimensions of luxury.

## A Brief History of the Concept of *Luxury* Consumption Goods

The concept of luxury has its roots in history. In the great civilizations of the ancient world, luxury goods have always been associated with wealth, exclusivity and power, as well as the satisfaction of non-basic needs. In ancient Greece, the habit of indulging in luxury was regarded as a threat to society because it was held that excessive pleasure would shift citizens' attention from the *polis* to private life. Until the fall of the Empire, the Romans assigned an ambiguous, potentially negative meaning to the word luxury. According to the *Oxford Latin Dictionary*, the term "luxury" comes from the Latin "luxus", which means "soft or extravagant living, sumptuousness, opulence", and shares a root with

the term "luxuria", which means "excess, lasciviousness, negative self-indulgence" (Dubois et al. 2005).

In the following centuries, the concept of luxury began to turn the "social acceptance" corner. The term tended to be associated with the Latin root "lux", which means "light", and to refer to precious objects (typically gold and gems) that were fashioned for kings, princes or church dignitaries. However, until the fourteenth century, the concept of luxury still had negative connotations among the common people. In Europe, it was only with the emergence of the bourgeoisie that the idea of luxury was associated with "sumptuous surroundings" that made life more comfortable. Europe's royal courts set the standards for lavish living. In ten years, Josephine Bonaparte managed to spend on clothing approximately half of the $15 million that France earned through the sale of the 500 million acre Louisiana territory to the USA in 1803 (Thomas 2007).

The transformation of luxury into precious objects and lavish living was necessary to open the realm of luxury to any social class. Finally, the second industrial revolution at the end of the nineteenth century gave the concept of luxury the modern meaning of the "habit of indulgence in what is choice or costly" or "something enjoyable or comfortable beyond the necessities of life". Of course, this transformation contributed to the different interpretations of the concept of luxury, such as status symbol, personal indulgence and leisure time, among others (Okonkwo 2007).

The modern industry of luxury goods has its origins in nineteenth-century Europe. In the wake of the industrial revolution, some entrepreneurs established companies to intentionally create exceptional products for the lifestyle of the social elite of the time. Before this period, luxury goods were produced by hand by local craftsmen and were primarily sold on the local market. Because modern industries required relatively high volumes and the potential for local growth was limited, these companies had to expand sales outside their country of origin to reach a larger customer base, establishing the basis for present-day global luxury companies (Antoni et al. 2004).

The economic growth in the twentieth century, which broadened the customer base of luxury firms, as well as the reputation for exceptional quality, drove the transformation of well-established brands. Initially, manufactured products attained the status of "luxury goods" due to their

superior quality, durability, performance or design. Today, the image of the brand has become one of the most relevant aspects for effective positioning in the luxury market, and emotional factors have acquired increased importance. Currently, many luxury customers want goods produced with the highest quality materials and most skilled craftsmanship, yet at the same time wish to be emotionally immersed in a memorable shopping experience.

A number of trends that emerged in the 1970s—a boom in travelling, an expansion of the range of luxury products and a growth in distribution networks—shaped the luxury industry. The 1980s saw an increased public exposure to luxury brands. Although the luxury market was a niche market with very limited access prior to the second half of the twentieth century, a trend towards "massification" has been observed in recent years with a growth in demand, an expansion from the traditional European and US markets to emerging markets, and an extension of the product range towards more accessible *mass-luxury* or *accessible-luxury* items (Lallement 1999; Catry 2003; Silverstein and Fiske 2003; Dalton 2005). Some authors (Letzelter 1996; Nueno and Quelch 1998) describe the emergence of new categories of consumers and new conceptualizations of luxury products (e.g., the distinction of luxury as a vehicle for personal satisfaction or as a means to achieve social status) as the *democratization* of luxury.

## Defining Luxury

The historical review of how the idea of luxury has been transformed over time reveals how its multifaceted nature makes it difficult to establish a clear definition based solely on the research literature.

### Expert Definitions

Most authors agree that luxury doesn't actually refer to a specific category of products but rather indicates a conceptual and symbolic dimension, which is strongly identified with the cultural values of the society of a

particular historical period. The ambiguity of the term luxury immediately becomes apparent when seeking a definition from "experts" in this field: "Luxury is what makes life more comfortable, more enjoyable, more fulfilling" (Pam Danziger, consultant); "Luxury is first of all everything that makes life easy" (Tom Ford, stylist); "Luxury is creating a safe and pleasurable public oasis" (Norman Foster, architect); "*For our customers the ultimate luxury is defined by exclusivity and customization*" (Giorgio Armani, head and founder of the Armani group); "Luxury is about the absence of vulgarity" (Coco Chanel, fashion designer and cultural icon); "Luxury is promising and maintaining the brand experience" (Silverstein and Fiske 2003). Practitioners as well as researchers have been unable to agree on an unambiguous definition of the term luxury.

## Academic Definitions

Most studies in the research literature do not differentiate between the terms "prestige", "status" and "luxury" (Dubois and Czellar 2002), although the first two terms display different nuances of meaning for consumers (Dubois and Czellar 2002; Dubois et al. 2001). Some researchers have investigated luxury as a characteristic of brands and have described it using vague terms such as "dream value" (Dubois and Paternault 1995) or "aura" (Bjorkman 2002). Finally, a few studies have differentiated between the concept of luxury and a luxury product or service. For instance, researchers such as Dubois and Czellar (2002) have focused on what the concept of luxury means to consumers (e.g., "luxury for me is having more leisure time in the day"); other researchers (e.g., Vigneron and Johnson 1999) have examined the meaning of luxury in the marketing context (e.g., what differentiates a luxury product from a high quality product). An additional confusion regards whether the term luxury primarily refers to a product or to a brand.

The point is that luxury companies are able to create value designing, manufacturing and selling product or services. As a consequence, the question that really matters is whether those goods (or services) can be considered luxury. Furthermore, given the focus of this book on the economic value creation of companies producing and selling luxury

goods and services, we leave to more philosophical works questions such as whether spending your retirement years on a desert island may or may not be regarded as a luxury.

## What Makes Certain Goods "Luxury" Goods?

Veblen was the first to note that luxury goods are not consumed for their intrinsic value but to impress others and signal wealth and conspicuous consumption (1899, cited in Piccione and Rubinstein 2008). According to Ng (1987), luxury goods are defined by their relative price and "are valued because they are costly". In contrast, Prendergast et al. (2000) observe that luxury cannot be defined solely in terms of higher price; and Dubois and Czellar (2002) note that expensive products may not necessarily be viewed as luxuries. For luxury goods, perceived high cost—in absolute or relative terms—is a necessary but not sufficient condition. In addition to high price, luxury brands feature excellent quality and specialized distribution channels (Kapferer 2001; Vigneron and Johnson 1999).

From a subjective point of view, the term luxury might refer to "things you have that I think you shouldn't have" (Twitchell 2003). Most luxury products are also associated with a strong brand name and logo, as well as a tradition of craftsmanship and high performance (Quelch 1987). Phau and Prendergast (2000) stress the role of the brand in evoking exclusivity; in their view, current luxury products have a well-known brand identity, enjoy high brand awareness and perceived quality, and maintain customer loyalty and sales levels. Hence, luxury objects should be recognisable, stimulate an emotional consumer response, and become incorporated into the customer's lifestyle.

Reddy and Terblanche (2005) divide luxury brands into two categories: those that primarily have symbolic value for the customer and are valued more for the associated lifestyle than for functionality (e.g., Louis Vuitton), and those that primarily have value due to their technical features (e.g., the world-class performance of Porsche vehicles). Despite the increasing use of branding to convey luxury status, luxury is not only based on the brand's symbolism. Perceived value—through quality of design, materials and manufacture—is another key component of the

luxury goods equation. The product must speak for itself; for example, if someone presents you with a €100 towel, it must be clear why it is a €100 towel (Hanna 2004).

Another important feature is the prestige associated with the brand and its uniqueness or exclusivity (O'Cass and Frost 2002; Kapferer 2001). Wetlaufer (2001) states that a luxury brand is timeless, modern, fast growing and highly profitable (although a premium price is also implied). As the balance between these four characteristics is difficult to achieve, luxury brands exist in a highly exclusive market niche that is driven by unique marketing phenomena (Beverland 2003), which suggests why uniqueness and exclusivity are relevant. Furthermore, this implies that specific management approaches for luxury businesses are worth developing in departments other than marketing.

Antoni et al. (2004) suggest that success in the luxury market is primarily related to:

- *Excellence*: for the consumer, the feature most strongly associated with luxury is the superior quality of the product and associated services, which is essential to justify the premium paid by consumers.
- *Brand aura*: for the consumer, continued excellence over time allows the brand to acquire a strong reputation and maintain a first class position. To achieve luxury status, brands need to have a strong, legitimate and identifiable aura.
- *Desirability*: luxury goods companies must create and maintain desirability. One feature of desirability is a strong aesthetic appeal that is modern but related to traditional values; another feature is high price, which strengthens the product's social status. The product's rarity and uniqueness also increases desirability.

Luxury is highly influenced by individual perception, and individuals' definitions depend upon what they value (Hanna 2004). However, it is possible to highlight some common elements that are identified by various authors. Combining these elements provides a set of CSFs that characterize luxury products and drive competition in the luxury market. Market experts (e.g., Altagamma 2008) agree that, due to the lack of an operational definition of luxury, the best option is to identify a set of product features that luxury companies view as desirable.

## The Critical Success Factors of Luxury

The above comprehensive analysis of the literature on "luxury" indicates that companies can pursue a luxury positioning for their brands and products (and apply the appropriate premium price) by cultivating the following CSFs:

- Consistently delivering *premium quality* in all the products in the line and along the whole supply chain, both through superior material quality and conformity to product specifications (Kapferer 2001; Vigneron and Johnson 1999; Nueno and Quelch 1998; Antoni et al. 2004; Hanna 2004; Altagamma 2008).
- A *heritage of craftsmanship*, which ensures the necessary expertise for manufacturing high quality objects (Catry 2003; Antoni et al. 2004; Hanna 2004).
- *Exclusivity* obtained through the use of naturally scarce materials, limited editions, limited production runs, selective distribution and the creation of waiting lists (Kapferer 2001; Vigneron and Johnson 1999; Phau and Prendergast 2000; O'Cass and Frost 2002; Catry 2003; Hanna 2004).
- A marketing approach that combines product excellence with *emotional appeal*; for instance, an attractive product display provides customers with an enhanced shopping experience, and the atmosphere at the point of sale reflects the values associated with the brand (Catry 2003; Moore et al. 2004; Danziger 2006).
- The global reputation of the *brand*, which conveys the idea of world-class excellence (Nueno and Quelch 1998; Phau and Prendergast 2000; O'Cass and Frost 2002; Antoni et al. 2004).
- A *recognisable style and design*, which means that consumers don't need to see the label to recognize the brand in some cases. For the luxury goods market, tangible features are insufficient. Customers must also respond to the product emotionally due to the product design and aesthetic (Catry 2003; Hanna 2004).
- An association with a *country of origin* that has an especially strong reputation as a source of excellence for a certain product category, such as Champagne from France (Nueno and Quelch 1998; Catry 2003; Okonkwo 2007).

- Elements that establish *uniqueness*, such as minor imperfections in hand-blown crystal vases (Nueno and Quelch 1998; Lamming et al. 2000; Catry 2003).
- Superior *technical performance* for brands based on technical expertise, such as sports cars. Best-in-class technical performance appeals to customers emotionally and allows them to distinguish luxury products from ordinary ones. For this product feature, continuous *innovation* can sustain product positioning (Catry 2003; Reddy and Terblanche 2005).
- The *creation of a unique lifestyle* that the customer can share in every day by possessing the luxury product (Nueno and Quelch 1998; Phau and Prendergast 2000; Reddy and Terblanche 2005).

It is not necessary for a luxury product to exhibit the entire set of CSFs. In the literature, exclusivity seems to be the aspect that is mentioned most frequently, which suggests that this factor is common to all luxury products (Catry 2003). With regard to the other CSFs, the brand, emotional appeal, style and design aspects tend to be emphasized more often than quality or performance for fashion goods; the opposite is true for sports cars. A typical luxury marketing strategy might leverage four or five of these factors. Consequently, depending on which factors predominate, a luxury product or brand might be categorized as a technological or an emotional luxury (Reddy and Terblanche 2005; Brun et al. 2006).

## Fashion Luxury and Accessible Luxury

### The Modern Oxymoron of Accessible Luxury

Historically, the term luxury has been applied to items that were both rare and available only to a privileged few (Nueno and Quelch 1998). Scarcity was initially inherent in the goods or the manufacturing process, but, over time, the production and diffusion of luxury items was often associated with an artificially created scarcity (e.g., monopolizing raw materials) or sumptuary laws. During the Industrial Revolution, wealth was distributed among a greater number of individuals, and

luxury became much more attainable. At the same time, modern manufacturing methods made it more difficult to claim intrinsic or natural scarcity. As a result, since the nineteenth century, the democratization of luxury has occurred at such a rapid pace that luxury itself has been constantly redefined. Goods and services once available only to an elite became available to everyone. For instance, indoor plumbing, which was regarded as a luxury a century ago, is now a normal feature of every house in most developed countries (Hauck and Stanforth 2007). This process has resulted in the appearance and diffusion of *accessible luxury* products (Okonkwo 2007; Thomas 2007).

## The Democratization of Luxury

The democratization process initially took place primarily in the fashion apparel industry, but other sectors soon followed suit. The luxury fashion industry experienced a paradigmatic transformation from tailor-made clothes to ready-to-wear haute couture to the current availability of industrially manufactured ready-to-wear apparel (Crane 1997). This metamorphosis illustrates the conversion from extremely exclusive products to less expensive and common ones. A similar development also took place for other industrial sectors competing on the luxury market, such as leather goods, shoes, furniture, watches, cosmetics, cars, yachts, food and services. Currently, especially in mature luxury markets such as Europe and the USA, middle-class households with burgeoning incomes have begun to shop for brands that were previously regarded as out of reach (Catry 2003). The most recent trend includes low-income individuals for whom the possession of a luxury-labelled product represents a *status* experience. Som (2005) notes the trend towards the *rationalization of prices* in the luxury market in which *new luxury* products are marketed to affluent and near-affluent consumers as a way to enhance their social status. In contrast, super-affluent consumers do not view new luxury products as valuable because they seek products with exceptional and unique features. Guyon (2004) states that currently luxury is often a “look-what-I-can-afford” status symbol and that the success of some luxury products is based on the presumed envy of consumers who cannot

afford the product. From this perspective, the accessible luxury category includes relatively low-priced versions of exclusive and expensive goods, which can be regarded as *envy leader* products.

This phenomenon does not simply describe the commoditization of initially rare goods. Rather, it illustrates the application of the "luxury" label to goods that could not have claimed that status earlier. In particular, both academics and practitioners who have discussed accessible luxury (Dalton 2005) have classified levels of luxury goods based on their *degree of luxury*. Some have proposed that the broader term "luxury" be separated into different categories and have also indicated the different CSFs associated with these categories:

- Fernie et al. (1997) observe that most of the companies in the luxury fashion business manufacture and sell *diffusion lines* in addition to their exclusive haute couture products. These are lower in price and available in relatively large volumes to reach a wider segment of consumers and introduce them to a lifestyle associated with the brand.
- Beverland (2003) divides the entire market for a type of product into four classes: the mass or *bulk* level, the *premium* level, the *super-premium* level and the *icon* level, with increasing exclusivity as a CSF.
- Dubois and Czellar (2002) note that exclusivity and desirability increase from *prestige* brands, which are characterized by high quality or performance, to *luxury* brands, which additionally include perceived comfort, beauty and refinement.
- Catry (2003) separates the luxury market into exclusive goods and accessible lines. Exclusive goods rely on rarity due to natural shortages of materials and manufacturing capacity, limited editions or artificially maintained rarity, while in accessible lines rarity is *information based* and achieved through selective distribution, exclusive shopping atmosphere, price, provenance from heritage centres, packaging and the combination of two brands.
- Silverstein and Fiske (2003) identify a *new luxury* category in which consumers are less interested in the product itself and more interested in the image associated with the brand. New luxury refers to goods that are not necessarily rare or manufactured in low volume; these goods acquire the luxury label due to design, additional services or the

aura created by the brand. The emergence of "accessible luxury" products is due in part to the tendency to *trade up* that currently characterizes consumption habits.

## Forms of the New Luxury

Heritage and prestige have always been the hallmarks of many luxury brands. Because some luxury brands are hundreds of years old, the enduring quality of a particular luxury good can be part of its appeal, and this is especially true for the traditional view of luxury. However, some consumers—particularly those who are young and fashion conscious—prefer a product with a fresh and unusual look and an exclusive aura rather than actual rarity (Hanna 2004). To attract this category of consumer, the brand image—focused on a label, a logo or a symbol—is crucial. This is the idea behind accessible luxury (or new luxury) as opposed to *old luxury* (or traditional luxury), which targets elite consumers and relies on product authenticity based on precious materials, heritage, craftsmanship and natural rarity. Instead, new luxury targets the upper-middle market, is positioned at a lower price, and includes three types of products (Silverstein and Fiske 2003):

- accessible super-premium goods: products that are priced at near the top of their category that middle-market consumers can afford;
- old luxury brand extensions: lower priced versions of goods that traditionally only the wealthy could afford;
- masstige (merging mass with prestige): premium products midway between mass produced and first class, which are well below the highest priced goods in their category.

Dalton (2005) notes the trade-off between exclusivity and availability, because exclusivity is essential for true luxury, while accessible luxury goods must be widely available.

D'Arpizio (2007) proposes a classification of luxury brands with three *levels* of luxury, observing that different performance is achieved in differ-

ent markets. These are consolidated by the fashion and luxury insight of Bain and Altagamma:

- *Absolute* luxury brands that are characterized by elitism, heritage and uniqueness (e.g., Harry Winston, Hermes). This segment includes the brands historically associated with luxury and manufacturers of precious products that traditionally drove the market. Indeed, before the crisis these brands dominated one of the most important luxury markets—Japan—with a growth rate of up to 3 % annually.
- *Aspirational* luxury brands that achieve their status by being recognisable and distinctive, which are represented by such brands as Gucci and Louis Vuitton. These brands exhibited the largest rate of luxury goods growth in the USA, exhibiting a peak annual growth of 11 % from 2005 to 2006.
- *Accessible* luxury brands, which are more affordable than their aspirational "relatives". Consumers purchase brands such as Coach and Hugo Boss to own a status symbol. This category is largely purchased by middle-class households in Europe and the USA but also exhibited a growth rate of 22 % in Asia-Pacific (excluding Japan), which was nearly two and a half times greater than the global average for accessible luxury sales growth. This suggests that sales growth in the Asia-Pacific region is driven by the high degree of entry-level access to luxury goods.

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# Part 1

## Discovering Luxury

# 2

# Luxury Dynamics

Emmanuelle Rigaud-Lacresse

This chapter presents the luxury sector and how luxury brands can be managed in a modern, critical way. It explains all you need to know to understand what is different about the luxury sector, including key concepts like value and value creation.

## Overview of This Unique World

As presented in the previous chapter, the concept of luxury is indeed complex: it is difficult to define because it is difficult to perceive as distinct from other sectors. This multidimensional notion has evolved throughout history, from prehistory to the twenty-first century. Originally, luxury was

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the result of hereditary social stratification; it was a social marker. From the opulence of the pharaohs to the fabulous Italian palaces, luxury was a symbol of ostentation. Over the years, luxury became less aristocratic and more bourgeois; brands appeared and multiplied; then industrialization developed. Gradually the notion of luxury became more complex: a market established itself, and industry awoke.

The first luxury organisations in France and in Italy were "family houses",[1] particularly in the fashion industry. In France, the family-owned business model dominated until the 1950s, when the Comité Colbert (a committee of 75 French luxury houses) was created. It was a symbol of a new age in the luxury industry, with increasing numbers of luxury groups. Indeed, it was the age of industrialization, and companies balanced their uniqueness, their knowhow and their production costs. Finally, in the 1990s, Bernard Arnault began to build a genuine luxury empire through mergers and acquisitions: it was the beginning of conglomerates and new management methods. Now the French model is dominated by this type of organization. This sudden emergence of international, multiproduct firms was the result of the acquisition of a whole series of independent small and medium-sized enterprises (SMEs) selling specialized products under famous brand names (Chatriot 2007). In Italy, the economy has been driven by the family model and entrepreneurship for a long time. In these SMEs companies, management focuses on long-term objectives to preserve their "family identity". The SME organizational model is more integrated; firms control distribution and are close to local industrial production and knowhow (Colli and Merlo 2007).

Beyond this "historic dimension", the luxury market is huge, dynamic and international; it exceeds €850 billion and has an overall growth rate of 7 %. It is also a heterogeneous market composed of nine segments, including personal luxury goods, cars, luxury hospitality, luxury cruises, designer furniture, fine food, fine wines and spirits, yachts and private jets, as explained in the report by Bain & Company.[2] Results vary widely between categories, and require in-depth analysis if conclusions are to

[1] "A business where more than half of the total shares are under control of the members of one family" (Som and Blankaert 2015, p. 158).

[2] Bain & Company, Inc., Luxury goods worldwide market study fall–winter 2014.

be made from them. For example, in 2014[3] when the luxury car market (€351 billion) grew by 10 %, designer furniture (€18 billion) decreased by 1 %. In addition, organizations are also heterogeneous, in terms of business structure. So, what exactly do we mean when we refer to the luxury market? It is important to define boundaries, because business models change. As Kapferer and Bastien (2008) explain, the luxury industry includes four main business models, depending on the proportion of products or services. The first two models, used for products such as fashion, accessories, jewellery, watches and automobiles, concern brands with extremely profitable core products. The third one involves the luxury services industry, such as hotels, and the last concerns high-tech products and services. These business models have management specificities. Some brands need to diversify their product portfolio to survive. For example, haute couture companies have to balance their core products and business with cheaper products. For heavy industry fixed costs are very high, and companies usually have to manage prices depending on their activity. This is the case for the hospitality industry, private jets and the cruise business. Companies producing high-tech products must innovate constantly. There is however an additional, all-digital, business model. Gemmyo is an excellent example in the luxury industry. This company, founded in 2011, sells exclusively online and produces to order. The model, related to lean manufacturing in the automotive industry, guarantees low prices—40 % lower than the market. The model also minimizes inventory costs. Gemmyo is an illustration of how the luxury sector evolves in line with transformations in the external environment. Each business model has its own rules in term of structure, organizational processes and management, which strengthens the diversity and complexity of luxury businesses. Each organization chooses a model in line with its objectives and its internal and external context.

Given that the evolution of the luxury sector is related to the evolution of society, it is essential to observe our dynamic environment if we are to understand critical success factors (CSFs) in the luxury world and how to manage luxury brands. More precisely, we have to consider the global environment of the luxury sector: the "luxury ecosystem". Indeed, each

[3] Bain & Company, Inc., Luxury goods worldwide market study fall–winter 2014.

company is a dynamic unit in a global network where "heterogeneous actors with specific competences intervene in the value creation process in different degrees and at different moments" (Depeyre and Seraidarian 2015). In the luxury industry, stakeholder profiles are extremely varied. Some are international suppliers; others are small scale companies or "craftsmen". Since the 1980s and 1990s, the luxury market has experienced one- or two-digit growth, depending on the sector. Globalization and digitization have led to enormous transformations in the industry. The world of luxury has changed; the rules are no longer the same.

Although the luxury market is mature, the number and variety of new luxury goods is increasing, and since the 1980s luxury has become more "democratized" (Silverstein and Fiske 2003). Consumer behaviour has changed, a class of wealthy people has emerged the world over (Som and Blanckeart 2015) and owning branded items has increasingly become part of popular culture. Finally, the inclusion of low labour-cost countries in modular production systems enables low-cost mass production of high quality products (Truong et al. 2008), with the appearance of "premium brands", such as American Calvin Klein and Ralph Lauren (Riot et al. 2013). On the other hand, some mass market or commodity brands, such as H&M or Zara, used "luxury strategies". These market dynamics impacted on luxury organizations and changed value chains. For example, small independent suppliers disappeared and some international companies acquired specialized knowhow by buying out their suppliers, such as Hermès, which purchased its oldest historical leather supplier, "Les tanneries du Puy", in 2015.

More recently, digitalization has given consumers a huge choice of readily available products and brands at affordable prices. The result of these changes is the phenomenon of trading up and trading down[4] (Som and Blanckaert 2015). For this reason, luxury products and services now have to distinguish themselves as commodities and premium products, and show their uniqueness by exploiting exclusive resources and competencies. Luxury brands have to create genuine value for everybody, starting with the client. Therefore, luxury brands are now developing their

[4] For more information see: Silverstein, Michael J., Neil Fiske, and John Butman, *Trading Up: Why Consumers Want New Luxury Goods–and How Companies Create Them*. Penguin, 2008.

own "comeback" strategies: returning to their origins, focusing on the brand's history and becoming more selective.

Hyper-connected, well-informed, consumers are increasingly demanding and are becoming stakeholders in the brand creation and development. They contribute actively to the life of the brand and compel firms to adopt new strategies and organizational transformations (Kotler et al. 2012).

The co-creation process is the main example of this (Hatch and Schultz 2010). All this raises the question: who is the luxury client? Now, luxury clients are not an "elite" but include very different characteristics depending on their cultures or profiles. They can be exclusive, occasional or regular consumers, and with the emergence of new luxury markets, such as China, India and Brazil, they can come from a variety of cultures. Indeed, whilst the American and Japanese markets continue to grow slowly and the European market remains stable, emerging markets consistently support market growth, introducing a new consumption style. New clients such as the Chinese perceive luxury products with different sets of parameters (Okonkwo 2009). The luxury goods industry is also driven by tourist spending,[5] so the challenge for luxury brands is to understand the buyers themselves better, rather than where they buy. In addition, as mentioned above, the rapid growth of digital information and new technology has modified consumer behaviour. Clients now want everything immediately. "New luxury" is defined by a "client-centric approach"; the consumer's viewpoint and experience is central.

In this context, is it possible to speak about luxury as an absolute or as a relative concept? And is this relativity on the level of culture, or of the business model? Or does it mean taking into account the fact that stakeholders in the luxury industry can be very different, with contrasting models and sometimes opposing objectives?

In this complex situation, managers have to find the right strategy to manage their brand, and particularly value, because the main characteristics of the luxury sector relate to value creation. Luxury goods consumption involves buying a brand that represents value both to the individual and to significant others (Wiedmann et al. 2007).

[5] Bain & Company, Inc., Luxury goods worldwide market study fall–winter 2014.

## Value and Value Creation: Key Concepts in the Luxury Sector

**Interview: Margaret Henriquez—Champagne Krug**

What is value in luxury and value creation in the luxury industry, and more precisely in Krug?

Luxury doesn't exist without value creation. The basic rule in luxury is that you always have to go further than what already exists and shed new light on things. This is why you really have to innovate continuously. That is how you create value, by surpassing yourself.

Building value doesn't mean cutting costs to save money. It means adding valuable features that we can use to create added value. That way we can keep investing and keep building value. We create a virtuous circle; that's how you create value.

Krug represents the art of the contrast … [It's full yet fine; it's fresh yet mature; it's magical yet modern]. Krug is a unique type of champagne house. Unique in its refinement … we work on detail, we never compromise. But it's never for perfection, it's for pleasure. We all insist on consistency and continuity while striving for modernity. Everybody in our house knows how they contribute to value creation. It's all in the contrast: demanding in our modernity and in our continuity based in our roots.

This section will explain what value creation means in the luxury sector, and how luxury creates value. Value creation is a central concept in the management and organizational literature, at both micro and macro level. From the strategic or marketing perspective, value creation concerns business owners, stakeholders or consumers; in human resources management or organizational behaviour, it concerns individual employees or employee groups (Lepak et al. 2007). Depending on the theoretical perspective, value creation is defined in different ways. For example, in strategic management Porter (1985) argues that value comes from diverse organizational activities, and represents the price that clients are willing to pay for a product or service. In the resource-based view (RBV), unique, rare, inimitable resources provide competitive advantage (Barney 1991). It is usual to distinguish between two dimensions of value: use value—the consumer's subjective valuation of consumption benefits; and exchange value—the amount the consumer actually pays, representing revenue to a value system (Bowman and Ambrosini 2000).

In luxury, the perception of value is difficult to define. Indeed, luxury has two major value dimensions, because luxury has two value perceptions: personal and non-personal, or luxury for oneself and luxury for others (Kapferer and Bastien 2009). So, purchasing a luxury product can be linked to personal motivations, in a hedonic view, or to a desire to "show off" (externalized luxury). For this reason, brands have significant power over purchasing intentions.

> In luxury, if somebody is looking at somebody else and fails to recognize the brand of his watch or to have an idea of (know) the price that goes with it, part of its value is lost. It is essential to spread brand and worth awareness far beyond the target group. This is the only way to build the distinctive facet of the brand (creating desire in the eyes of others). (Kapferer and Bastien 2009. p. 319)

These two facets can co-exist in one consumer and can be different, due to the cultural dimension (Vigneron and Johnson 2004).

Hence, managing value creation is a major challenge in today's luxury industry. In addition, due to environmental changes, luxury firms have to create value continuously. After the move towards popularization, organizations have to regain recognition. This means luxury brands must recreate a specific link with their extremely heterogeneous clients. Through the brand universe, the luxury firm has to reinvent a unique interactive experience for its clients.

Here, we are talking about a specific value creation process: first, on the value chain (Porter 1999), and, second, in brand development.

The supply chain is defined here as a network of firms that contribute both upstream and downstream to the different processes and activities that create value in the form of products and services provided for the end consumer (Christopher 1992; Mentzer et al. 2001).

Value creation comes from the management of each process through the supply chain, and in the complementary and specialized resources that support them. More particularly, in the RBV, dynamic capability view, value creation can originate in complementary, specialized resources and competencies, as well as in the capacity to create unique combinations (Teece et al. 1997; Wernerfelt 1984).

In the luxury industry, expertise and knowhow are essential. Indeed, luxury professions require particular expertise, the unique knowhow of

craftsmen, which must be passed on over time and also evolve in line with transformations in society. It seems therefore essential to identify this key knowhow and maintain it within the value chain.

Second, brand development: a brand enables the organization, or the structure that supports it, to position and differentiate itself. Its increasing role in society gives organizations competitive advantage (Kapferer 2007; Craciun and Barbu 2014). Thus, developing a brand involves creating a series of non-negotiable values that provide it with a unique identity. More particularly in the luxury sector, brands represent the firm, its values and all the underlying perceptions that customers adopt (Bastien and Kapferer 2008; Dereumaux 2007). They provide a symbolic dimension and emotional value. More recently, the gradual digitization of brands is transforming them into a vector for a wide range of exchanges. The name is the consumer's first contact with the brand, and it must operate as the way into a unique universe. Based on this name, the brand creates a specific, one-of-a-kind language to give it meaning. The language must evoke a world that respects the consumer's opinion. Whilst constantly listening to consumers and proposing new offers, the firm that manages the brand must ensure that the consumer does not feel harassed. Now the consumer is a part of the brand and contributes actively to the brand construction. Organizations have to think in a different way. The notion of brand, still considered as identity building, has taken on other dimensions. Some authors speak of a new, more global, more integrated, more cross-functional brand vision. The brand does not exist only for the customer, but is positioned at the heart of the organization and its consumer relations (Michel 2013; Kornberger 2010; Hatch and Schultz 2010). Consequently, brands develop differently; they have to bring together a community of individuals: customers, suppliers, investors and so on, who do not all necessarily have the same objectives with regard to the brand. This necessary balance between the different stakeholders and the brand has given rise to a new model that some call "brand ecosystem" (Lautissier and Angot 2009). The idea of this is to create and maintain durable relations between the brand and its community, which will become as one. The key notion is now experience: the brand gives people a unique experience, which they share with the rest of the community.

Today's luxury firms find themselves in an unstable, constantly mutating environment. Markets are increasingly competitive, with new players, emerging markets, new client profiles and the emergence of the internet,

which has changed consumer–manufacturer relations. So, the challenge is enormous. To create value continuously, luxury organizations have to adopt strong, dynamic strategies to highlight their roots and the values of their brand, and thus maintain their identity and prevent it from losing its strength (Sylverstein and Fiske 2003; Hoffmann and Coste-Manière 2011; Riot et al. 2013). At the same time firms must anticipate market trends. This means that luxury brands have to guarantee a “fixed” identity, the “DNA”[6] of the structure that bears it, giving it a face, a personality and a soul. But the brand must also position the structure within its environment. It guarantees uniqueness and, as such, it has to evolve to enable the organization to retain its competitive advantage. How can this paradox be managed?

It is necessary to understand luxury brand management, how it is supported and which processes it is responsible for. More generally it is necessary to fully understand all the processes—from conception to delivery—of luxury brand management.

**A New Vision of the Luxury Brand: Brand as an Output**

Brands, the key asset for luxury organizations can be viewed in a specific way. Indeed, to understand fully the processes and competencies supporting the brand and how to manage the paradox, once can consider the luxury brand as an output. Thus, the brand becomes the result of the processes developed and transcribed not only by the firm (Rigaud 2009), but also outside the firm, since the brand can be co-created with customers (Hatch and Schultz 2010) and other stakeholders (Michel 2013).

The brand is thus: a corporate activity, which initially creates products and value using the organization’s internal resources, but then using external resources, which take an active role in the brand’s development and renewal. The brand can be considered as an identifiable result, modelled and remodelled by different internal and external actors over time.

More precisely, the brand is the result of the actions of various departments within the organization: principal and support activities (following Porter 1999). It is also the result of processes outside the organization, such as innovative processes implemented by suppliers (Michel 2013), distribution processes and, of course, co-creation processes with customers (Kotler et al. 2012), and sometimes with other stakeholders.

So, the brand can be viewed as the result of interactions in different value chains: the upstream supply chain, the support organization, and the distributors and customers downstream. Therefore, it is important to understand value chain dynamics and how they can create value.

[6] DNA: deoxyribonucleic acid: it means the core value—the identity.

### *Understanding Dynamic Processes in Luxury in Order to Manage Opportunities*

As mentioned in the first two sections, in the increasingly demanding luxury environment, the structure of luxury sector has changed fundamentally. Indeed, with industrialization, the creation of multi-brand groups (in international corporations), emerging markets and relocation, the rules have changed. Value chains have been modified, with vertical and/or horizontal integration. In this fuzzy world, luxury companies aim to retain key resources and create value continuously. This value comes from specific resources and competencies in the luxury sector and also comes from all processes along supply chains and within companies. Value results from the interaction between the brand and stakeholders, and in particular, clients. With this bottom-up strategy, consumer behaviours and new technology have created a genuinely innovative dynamic in the luxury sector.

More particularly, when considering brands as a specific asset, bearing marketing rules in mind is crucial to luxury management. Indeed, these rules often provide valuable guidelines for strategy orientation. Luxury products and services are unique; they have a unique history and heritage; so positioning is not an issue. Luxury must appear inaccessible (rare and expensive), and at the same time must enable a large number of consumers to dream. As such, it must be everywhere internationally, but must not be easy to purchase. Thus, luxury must remain at a distance from consumers, and at the same time must let them be part of its universe, by providing them with a unique experience and interacting with them.

Managing a luxury brand includes guaranteeing extremely high product quality and services using a structured, reliable production system and controlling the supply chain; creating a tangible and intangible universe to tell a unique story, relying on creativity and innovation to remain unique; controlling image, distribution and brand architecture (portfolio development); and, finally, protecting the brand's territory to retain its uniqueness and distinctiveness (Keller 2008).

These different elements highlight the fact that luxury management today is an extremely contradictory activity, together with the importance of understanding and controlling the different processes and interactions involved between the design of a product or service and its delivery to the consumer.

For this reason, a cross-functional view is necessary, including finance, strategy, marketing, economics and law, to understand fully each process together with how it relates to value creation and management.

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# 3

# Global Organizational Leadership for Luxury Companies

**Karina R. Jensen**

A dynamic global marketplace demands new ways of leading and managing in the luxury industry. In managing and sustaining value for a new generation of luxury customers, the brand needs to demonstrate a global and local connection within a multicultural and digital environment. The changing needs and opportunities of emerging and mature markets are requiring international luxury companies to improve organizational collaboration and innovation. In order to ensure value and performance for multicultural markets, leading multinational firms in the luxury industry are transforming their leadership teams, organizational cultures and operational strategies. Within this changing environment, how will global leaders manage and sustain organizational effectiveness and international market success?

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This chapter will address leadership and organizational needs when managing innovative luxury brands and products for international markets. It will discuss considerations for organizational leadership and managerial competencies as well as the impact on organizational culture and innovation. Organizational considerations are linked to market impact when examining leadership and strategic implementation of leading luxury firms, including the operational needs for managing global and local market dynamics. In contributing to theoretical understanding as well as insights to new practices, this chapter provides an overview of leadership and organizational competencies required for achieving international market success and competitive advantage in the new and evolving luxury industry.

## The Impact of Global Market Dynamics on Organizational Leadership

With an increasingly global and dynamic marketplace, there is the need to quickly identify and respond to the diverse preferences and demands of mature and emerging markets. According to the Bain Worldwide Luxury Study (2014), the global luxury market exceeded €850 billion where the USA remains the largest global market with an estimated growth of 5 %, followed by Europe (primarily France, Italy, Germany and UK) and a strong third for the Asia-Pacific region. While mature markets such as Europe, North America and Japan have a larger combined share of the luxury market, growth rates are increasing for emerging markets in Asia-Pacific and the Middle East. Industry reports consistently show increased growth in the Asia-Pacific region with China, South Korea and Southeast Asia leading the way at home as well as influencing luxury shopping patterns and tourism flows in other world regions (D'Arpizio et al. 2014). The impact of global competition and changing luxury consumer preferences have placed increased emphasis on product and service innovation in order to succeed and expand in international markets.

There is a growing need for a customer-centric focus with innovation as a driving force for brand communication, products, services and experience (Wealth and Luxury Trends 2013). The capacity to act on

consumer insights and orchestrate organizational resources requires a flexible and responsive network. As international markets demand quality and value for products and services, luxury firms are facing increased pressure to optimize knowledge across the organization in order to understand local tastes. Value as a function of tradition and quality with authentic design also requires careful interpretation of cultural preferences. The new multicultural and networked business landscape has therefore created a growing need for knowledge-sharing between business and design teams around the world. This requires leadership that can facilitate and optimize global and local knowledge in order to improve the creation and execution of new products and services worldwide. In order to foster innovation from concept to market, luxury firms need to consider improved organizational collaboration for connecting global and local knowledge as well as building a shared culture of innovation.

Today's luxury firm faces the same challenges as organizations in other sectors where customer insights are important to gather and evaluate for effective planning and execution. The past economic crisis and recession in 2009 was a wake-up call for the luxury industry, where its future is being built upon the capacity of brands to understand the scope and language of customers (Som and Blanckaert 2015). This requires optimization of talent and knowledge within the organization. Resource and knowledge combination are critical to creating value and responding to customer demand, in addition to achieving a competitive advantage through continuous innovation as well as effective exploitation of innovation (Verbeke 2009). There needs to be a balance of innovation exploration and exploitation of the luxury goods portfolio with insights to particular consumer preferences. In the past, a global strategy with a unique offering highlighting the luxury brand's history worked well with a select customer profile around the world. Today, the growing luxury consumer demographic has changed across mature and emerging markets; a profile that is younger, open to innovation and less loyal to a brand. The organization's ability to capture and integrate local market knowledge influences its global market performance.

## Global and Local Team Collaboration in Mature and Emerging Markets

Global product and service innovation through geographically distributed and cross-cultural teams have created a greater need for co-creation and collaboration. With higher growth experienced in emerging markets, luxury firms will need to develop and collaborate with local talent in order to better understand international customers and markets. In order to integrate global and local perspectives, social embeddedness and relations become essential in the development of strategy and capabilities through shared understanding and interactions in strategy making (Regner and Zander 2011). Efforts to share knowledge and increase innovation in organizations are likely to fail unless they are built on a firm foundation of social capital, the relationships of trust and mutual understanding that make knowledge collaboration possible (Cohen 2007). A cross-cultural and networked business environment has created a growing need for knowledge-sharing between headquarters and subsidiaries.

Most luxury firms are characterized by private family-owned firms or members of large conglomerates where they enjoy an international presence in key markets around the world. When working within a multinational structure, it is often challenging to facilitate exchange between geographically distributed team members located at global headquarters and local subsidiaries. Knowledge transfer requires the development of strong and trustworthy relations, especially within organizational boundaries, including cognitive, structural and relational capital (Jansen et al. 2008). Networks and social capital play an important role in developing cross-cultural collaboration through trust-building and knowledge-sharing during the global innovation process. Moreover, collaboration serves an important role in nurturing and sustaining knowledge sharing throughout the organization. Inter-team and intra-team cooperation have been found to serve as significant determinants of knowledge generation by subsidiaries (Mudambi et al. 2007). Therefore, it is important to consider organizational collaboration and global team performance as critical factors for international market success.

## Leading and Managing Through New Leadership Competencies

Due to the need for increased local market knowledge and collaboration, organizations in the luxury industry and across sectors are moving towards more decentralization. This requires leadership that can ensure recognition and responsiveness to new ideas and knowledge shared by local teams. Engagement of local teams in the planning process through meaningful insights and contribution can increase motivation as well as project success. Increased travel and face-to-face communication can improve collaboration, in addition to leveraging technologies for knowledge-sharing platforms and tools. Transparency, open and honest dialogue, and the provision of sufficient knowledge improves understanding and contribution to the design and delivery of luxury concepts. It is the ability of leaders to facilitate knowledge sharing between teams at headquarters and local subsidiaries that improves collaboration and knowledge sharing within the organization.

Leaders require increased cultural understanding and collaboration skills in order to accelerate innovation and responsiveness to international markets. Specific leadership competencies are needed for facilitating collaboration and knowledge sharing when working in a multicultural and networked environment. A study (Jensen 2015) revealed four leadership behaviours that involve empowerment, communication, inclusion and direction. In reviewing the kind of leadership style preferred by local management teams in Asia, the study participants confirmed similar qualities with a special emphasis on competencies related to directive and inclusive leadership where there was a preference for directive leadership while ensuring relationship building and collaboration for ideation and planning. The local study showed that traditional views of competition, knowledge as power and saving face can be transformed through specific leadership practices such as cultural empathy, collaboration, empowerment and a common goal for achieving team and organizational success.

The emphasis on a global innovation strategy and centralized planning at headquarters with decentralized execution at subsidiary locations reduces the motivation of local team members to collaborate,

which impacts market performance. Thus, it will become increasingly important for leaders to inspire, develop and sustain local talent that can contribute to the firm's strategy. Leaders will need to orchestrate collaboration and knowledge sharing that can drive creativity and innovation worldwide. The study supports findings from a Spencer Stuart report (2009) on "Leadership in the Luxury Industry" where there is more emphasis on European expatriate talent than development of local talent in the Asia-Pacific region. It will become increasingly critical to develop and optimize local talent that can share and contribute knowledge from design to execution.

The openness to hiring leadership talent with diverse profiles and the movement toward a more decentralized structure is best exemplified by Chanel and Gucci. Serving as Chanel's CEO from 2007 to January 2016, Maureen Chiquet is an American executive who brought substantial operational experience from L'Oreal and Gap. Leading Chanel through a phase of global growth, Chiquet brought a consultative and collaborative leadership style that helped her develop a strong and recognisable vision embraced by employees and customers. Recognized as being a good listener, she travelled throughout the world to spend time with frontline teams and store employees in order to understand and develop talent from diverse cultures and regions (Dowling 2008).

Leadership at Gucci has nicely evolved to emphasize empowered management. The organization has moved from a centralized to a decentralized structure since the high powered era of Dom de Sole and Tom Ford. Robert Polet, who was hired from Unilever, skilfully led a period of global expansion through his relentless focus on freedom and autonomy to business group leaders. The renewed strategy focused on creating value for the brand, and not the star designer. Today, the group is led by Marco di Bizzarri, who took over from the successful era of CEO Patricio di Marco who had strengthened the practice of empowered leadership by emphasizing creativity, business focus and people development at Gucci. Marco di Bizzarri is extending this philosophy further by empowering teams around the world through a leadership philosophy that is based upon respect, listening, openness, co-creation and innovation. To demonstrate his leadership style through engagement, di Bizzarri visited most of the country offices in order to present and discuss the new vision and strategy as well as encourage initiatives for 2016 and beyond (Amed 2015).

## Sustaining a Global Innovation Culture

The great advantage found within the luxury sector is often the strength of a firm's organizational culture—the values, philosophies and attitudes that speak to the rich heritage and tradition of luxury. With an international presence and increased growth in emerging markets, it is important to consider the development of a global innovation culture that is focused on cultural empathy, collaboration and creativity. Cultural empathy emphasizes the importance of nurturing cultural diversity and global teamwork by recruiting global talent and developing culturally diverse teams. This requires an awareness and openness to other cultures through international education, projects, exchanges and collaboration worldwide. Creativity is focused on idea generation and innovative thinking, where the continuous development of new ideas along with free-form thinking is essential for innovation. Collaboration refers to communication and transparency with an emphasis on global and local collaboration. Organizations with strong innovation cultures leverage local market knowledge through a focus on cultural empathy, creativity and collaboration.

In responding to global and local market demands, a strong innovation culture can promote cross-cultural understanding, idea generation and knowledge-sharing that enhances creativity and innovation. The formal culture and rigid structures of traditional luxury firms are starting to embrace a more open culture and flexible structures that appeal to a younger generation of creatives and managers. Luxury firms also need to pay attention to the top-down communication flow from global headquarters to local subsidiaries, which could serve as a challenge for collaborative exchange between global and local team members. Overall, the shared passion for the brand and unique offering unifies the culture. The focus on brand value can enable innovation through more time, space and freedom for teams to create new ideas and concepts that respond to international market opportunities.

Kering is a successful conglomerate and luxury group that has a portfolio of leading brands such as Gucci, Saint Laurent, Bottega Veneta, Alexander McQueen and Boucheron. The group made a transition in 2013 when it unveiled a new name and focus on creating an innovative organizational culture. The "ker" means home in Breton and its

English meaning is linked to the word "caring". The core values of the organizational culture are focused on integrating complementary brands through a sense of family, where pride and passion for their offering sustain creativity and innovation. The group's purpose is to show that it cares for its brands, employees, stakeholders and the environment. There is strong focus on creativity and collaboration through operational and communication support across groups, in addition to an emphasis on sustainable development that is shared amongst the teams in every group (Kansara 2013). Enjoying successful growth in international markets, Kering continues to connect with local talent in order to develop innovative collections that appeal to its multicultural audience.

## Nurturing Internal Dialogue Through a Digital Network

The digital landscape and networked environment brings a strong focus on customer relations through new technologies such as social media, big data and e-commerce. However, the luxury sector has been slow in adopting online marketing and communication opportunities whereas the web experience and online shopping are increasingly of interest to customers. In order to create a strong online connection with luxury customers, a corresponding internal use of online technologies is needed for creative and communication teams. Luxury firms need to invest in a dedicated technology platform for ideation and knowledge-sharing as well as complementary technology tools that can facilitate team and organizational practices. They also need to consider a knowledge structure to guide the innovation and collaboration process from concept to execution. Organizational resources in the form of new technologies for innovation, learning and knowledge sharing can enhance dialogue from local to global teams.

Communication technologies and tools are important for internal communication and weekly project interactions; however, live interaction is always important for building trust and developing relationships. In addressing knowledge-sharing practices, leaders and teams should emphasize increased face-to-face interaction and communication with travel and visits between the headquarters location and local subsidiaries

in order to improve cultural understanding and local market knowledge. Open and continuous dialogue between geographically distributed teams in key world regions serves as a powerful catalyst for sharing challenges and finding solutions that will reinforce global brand value.

Burberry is a leading luxury firm that has truly succeeded in developing its own digital network with the use of social media and new technologies for communicating with employees and customers. Its effective use of digital media has demonstrated the luxury sector can integrate high fashion with modern technology to enhance the in-store experience and build brand loyalty (Ahrendts 2013). Customers can enjoy online experiences through interaction with the website and social media campaigns that invite their personal stories. This digital revolution is largely successful because the use of knowledge platforms and social media are equally important inside the organization (Ahrendts 2013). Top management has been able to organize regular online communication and collaboration with employees around the world through digital updates, presentations and chats where knowledge can be shared between teams worldwide. This includes technologies that can be used across functions, from research to marketing to customer service, for improved performance.

## Enabling Connections with Global and Local Customers

The rapidly evolving international business environment is demanding more responsiveness and organizational agility within the luxury sector. Globalization, diverse consumer groups and the increased need for adaptability have affected the corporatization and creation of conglomerates from family businesses (Som and Blanckaert 2015). They represent multinational firms with complex structures and a worldwide network of employees and customers. The operational strategies of Prada, Ferragamo, Gucci and Chanel in the recent years demonstrate a continued focus on China and the Asia-Pacific region while maintaining growth in Europe and the USA for the expansion of both retail channels and e-commerce activity (PwC 2012). The importance of a customer-centric strategy with international appeal for retail and e-commerce demands greater

attention to local market connections. Teams need to effectively share local knowledge for developing innovative solutions that respond to local market needs. This demands organizational communication processes that facilitate the sharing of local knowledge and thus contribute to innovative market solutions and successful project initiatives across countries.

There is the necessity to understand the customer profile, preferences, needs and expectations in developing a suitable offering. The planning phase requires alignment between the leadership team in headquarters and the teams in local markets in order to ensure the strategy meets local market expectations. It relies upon knowledge of local market requirements to determine the level of adaptation required for a new concept. In order to increase knowledge sharing and contribution during planning and execution, luxury leaders need to consider five elements that influence motivation: recognition, empowerment, interaction, open communication and organizational support. While challenges are often linked with global or centralized strategy making and planning, motivation is regularly associated with local strategy making, collaboration and open communication (Jensen 2015). The lack of local market understanding by senior managers based in headquarters is perceived as a challenge to innovation since a lack of cultural and market awareness result in the creation of customer solutions that do not meet local market preferences.

## Conclusion

In order to create value and sustain change, luxury firms will need to develop leaders that can demonstrate cultural understanding and collaboration with geographically distributed teams in order to accelerate innovation and responsiveness to international markets. Collaboration and knowledge sharing require consideration of specific organizational routines that interdependently create a common space and environment for innovation. In order to sustain a collaborative dialogue across functions and cultures, the leader serves an important role as knowledge facilitator. The global organizational leadership model in Fig. 3.1 demonstrates the

**Fig. 3.1** The drivers of global organizational leadership (*Source*: Dr. Karina Jensen, 2016)

importance of developing a global innovation culture through capable leadership and a responsive organization. In this way, luxury firms can consider the orchestration and configuration of global team knowledge as a resource and competitive advantage when facilitating innovation for international markets.

Today's luxury firms need to consider effective transnational management, a global brand image with local connection, effective retail management with superior customer experience, and powerful engagement with local customers through relationship-building strategies. This will require the development of capable leaders with a global mindset and understanding of customers in diverse cultures and markets. Moreover, this can only be accomplished through the development of a global innovation culture that can optimize creativity and collaboration through a diverse talent pool located in mature and emerging markets.

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# 4

# Financial Reporting and Communication in the Luxury Industry

Laurent Hervé

One of Finance's guiding principles is that managers should manage the firm's resources to create value. This appears obvious, but many firms are not managed in that optimal fashion: poor decisions, or a lack of decision making, can limit the firm's potential, and the key questions are: are the right decisions taken and is overall performance creating the expected value?

Value creation is, of course, of paramount interest to the firm's owners, the shareholders who back the firm through its equity capital, but also to debt-holders, who lend money through debt capital. But it also concerns the company's other stakeholders: employees, customers, suppliers and the community. No firm can succeed without them, as they contribute to its operations and its success, through their motivation, loyalty and sturdy, longstanding relationships, which enhance the organization's valuation and durability.

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However, establishing long-term partnerships with clients and suppliers, emphasizing staff motivation and focusing on environment protection do not guarantee maximum value and goodwill creation. If the optimal value creation does not meet the expectations of the firm's shareholders—for example, because of an insufficient return on capital—managers should take the necessary measures—for example, by modifying the firm's strategy to increase its performance.

In this context, how does one manage value creation effectively?

The answer is, by optimizing actual business performance and the key elements shareholders consider when forming judgments through the firm's financial communication. Maintaining the short- and long-term viability of the firm through effective risk management is one of the key drivers to be considered. Another is making sound business decisions through capital budgeting and project management.

These basic principles apply of course to the luxury industry, but in this sector, value creation is guided by certain specific features.

Above all, the *enhancement of brand value*: this represents the most significant part of the net worth of a luxury firm (its net worth corresponding to the difference between its assets, whether or not they are accounted for in the balance sheet, and its liabilities). Since brands and trademarks are central in luxury company marketing processes, maximizing them maximizes the firm's value, and thus its shareholders' profits. To a certain extent, priority should be given to asset valuation rather than to profit maximization. Maximizing profits has a positive impact on the development of brand value, but can entail detrimental effects when short-term profit enhancement strategies are conducted through intensified sales programmes or unjustified cost cutting.

The brand valuation techniques and the key variables that influence them have already been presented earlier in the book. These parameters (margins, operational efficiency ratios, returns on assets or on equity, cash-flow generation…) are mainly performance driven, and are most often those used when analysing luxury firms financially. This chapter details these key financial indicators used for the internal management of the firm but also presented in their financial communication.

## The Basics: Understanding and Analysing Luxury Firms' Financial Statements

Like every firm, luxury companies have a legal or regulatory requirement to provide and communicate financial information on their business transactions and financial status. Their accounting system, which has to respect generally accepted rules nationally (generally accepted national accounting principles) or internationally (IAS/IFRS), enables them to collect and record this information and summarize the data into documents called financial statements. This is done at individual (company) level, and at group level (consolidated accounts) in the case of parent companies and the companies they control or influence.

The principal financial statements are the balance sheet, the income statement and the cash-flow statement. Using the information contained in these statements, one will be able to judge the firm's financial situation and performance, and determine whether it is creating value.

## Interpreting a Balance Sheet: The Example of the LVMH Group

The purpose of a balance sheet is to provide an estimate of the net investment made by the firm's owners (called shareholder's equity) at a specific date (the close of an accounting period, a yearend for example). Shareholders' (or owners') equity is the difference, at the reference date, between what the firm's shareholders collectively own—called assets, such as cash, inventories equipment and buildings—and what they owe—called liabilities (mainly debts owed to banks or suppliers). Shareholders' equity corresponds to the amount initially or subsequently invested in the firm by the shareholders (capital) or earned by the company and not distributed to its owners (retained earnings or reserves).

In the IFRS presentation, assets are usually listed in increasing order of liquidity, with liquidity measuring the speed with which assets can be converted into cash. In this spirit, assets are subdivided into non-current assets and current assets.

**Table 4.1** LVMH group balance sheet at 31 December 2014 (in € millions)

| | | | |
|---|---|---|---|
| Brands | 13,031 | Share capital and premium | 2,807 |
| Goodwill | 8,810 | Reserves and sundry | 13,308 |
| Property, plant and equipment | 10,387 | Net profit group share | 5,648 |
| Other non-current assets | 3,024 | Minority interests | 1,240 |
| **Total non-current assets** | 35,252 | **Total Equity** | 23,003 |
| Inventories | 9,475 | Long-term borrowings | 5,054 |
| Accounts receivable | 2,274 | Other non-current liabilities | 13,130 |
| Other current assets | 2,270 | **Total non-current liabilities** | 18,184 |
| Cash and equivalents | 4,091 | Short term borrowings | 4,189 |
| **Total current assets** | 18,110 | Accounts payable | 3,606 |
| | | Other current liabilities | 4,380 |
| | | **Total current liabilities** | 12,175 |
| **Total Assets** | 53,362 | **Total Equity and Liabilities** | 53,362 |

Table 4.1 presents the summary balance sheet (or statement of financial position) of the Louis Vuitton Moet Hennessy (LVMH) Group for the 2014 financial year. This well-known diversified luxury group owns, among other brands, Louis Vuitton, Christian Dior, Moet et Chandon and Bulgari.

## What Conclusions Can Be Drawn from This Balance Sheet?

As regards assets, the non-current assets mainly comprise:

*Brands, trademarks*. These intangible assets are recorded at their historical price when they were acquired, and depreciated if they have a finite lifespan, or impaired if they lose value.

*Goodwill*. This appears when a company is acquired at a price higher than the fair value of its net asset (assets–debt liabilities). Goodwill or brands created inside a company never appear on its balance sheet, in application of the accounting principle of "conservatism".

*Fixed assets*. These include assets, such as property, plant and equipment, which are depreciated over their useful life.

*Investments*. Financial investments in non-controlled companies.

Current assets comprise:

*Inventories*. These are goods held for use in manufacturing (raw materials), work in process or finished goods. They are valued at lowest between cost and market price.

*Trade receivables*. Often firms grant credit terms to customers (especially in business-to-business transactions). Receivables are the amounts owed to them on realized sales. They will be transformed into cash payments, normally at the end of the credit period. There are usually no receivables for retail customers, who pay cash or by credit card.

*Other current assets*. These can represent advances or other receivables such as recoverable taxes.

*Cash and cash equivalents*. These cover cash-in-hand and bank deposits. Net of overdrafts, included in short-term borrowings, the final cash position of LVMH comes to € 3,783 billion.

The following features of the LVMH balance sheet are striking, and are common to most large luxury companies:

- The importance of brands and of goodwill. This is the case for all firms that have had an external growth policy, buying companies for their market reputation and their future profitability.
- The relatively few fixed assets: luxury firms usually have less equipment than industrial firms, but can own real estate and a network of retail stores.
- Inventories can be high if they are in spirits or luxury fashion.
- Receivables are low, except when they distribute through retailers or duty free shops.
- As for cash, this is frequently a comparatively high figure, when firms are profitable and/or family owned, for prudence purposes.

As regards liabilities, a distinction should be made between equity and debt liabilities:

*Shareholder's equity* corresponds to the net worth owned by shareholders. It is equal to the capital invested initially (expressed as a number of shares multiplied by a nominal issue price) or subsequently, and the

profits retained by the company rather than distributed through dividends (retained earnings or reserves).

Because assets = liabilities in double entry accounting, Shareholder's equity is equal to assets minus debt liabilities, and thus corresponds to the accounting net worth of the company. It is related to the market value of the company (which corresponds to market share price × number of shares), but can be above or below this. In the case of LVMH, market value is usually two to three times book (accounting) value.

*Debt liabilities* are subdivided into two categories:

*Non-current liabilities* are mainly medium- or long-term debts, issued on markets (bonds) or lent by banks.

*Current liabilities* include the less than one-year portion of non-current debt or other short-term payables such as that of suppliers (accounts payable) or taxes due.

Most high-performing luxury companies are mainly financed in the long term through equity, and they have low debt levels. Their short-term liabilities are mainly generated by their operating activity.

## Analysis of the LVMH Group Income Statement Is Given in Table 4.2

As a reminder, the purpose of the income statement (or profit and loss account), is to synthetize the firm's transactions during an accounting period (one year, or a fraction of it) that have contributed to the change in shareholder's equity.

*Revenues* (mainly sales, but also other income, such as fees) increase the net worth of the firm, whereas expenses (such as purchases or wages etc.) decrease it. The net change represents the earnings (profit or loss) for the accounting period. Revenues and expenses are recorded with respect to realization and matching principles, that is, recording in the accounts when the transaction occurs and not when the cash is received or paid out; and linking revenues generated to the related expenses incurred. These principles are called accrual accounting.

**Table 4.2** Summarized consolidated income statement of the LVMH group for the 2014 financial year (in € millions)

| | 2014 | | 2013 | |
|---|---|---|---|---|
| **Revenues** | **30,638** | **100 %** | **29,016** | **100 %** |
| Cost of sales | (10,801) | 35.2 % | (9,997) | 34.45 % |
| **Gross margin** | **19,837** | **64.8 %** | **19,019** | **65.55 %** |
| Marketing and selling expenses | (11,744) | 38.3 % | (10,767) | 37.1 % |
| General and administrative expenses | (2,662) | 8.7 % | (2,354) | 8.1 % |
| **Operating profit** | **5,431** | **17.7 %** | **5,898** | **20.3 %** |
| Cost of net financial debt | (115) | 0.5 % | (101) | 0.3 % |
| Other financial income and expenses | 3,062 | n.a. | (97) | n.a. |
| **Profit before tax** | **8,378** | **5,700** | | |
| Income tax | (2,273) | (1753) | | |
| **Net profit** | **6,105** | **19.9 %** | **3,947** | **13.6 %** |

In the luxury industry, sales usually represent the principal revenues, together with royalties on licensing. At first, they are usually realized domestically; then, with the development of the image, exports often become a significant proportion of total revenues. In the case of LVMH, exports represent almost 90 % of total revenues. Analysing the growth of sales from one year to another is always a starting point for performance judgement. In the case of LVMH, sales increased by 5.6 % from 2013 to 2014; this is very satisfactory growth for a multinational group of LVMH's size.

*Cost of sales* (or cost of goods sold) represents the direct or indirect cost of purchasing or manufacturing the goods that have been sold during the accounting period. These costs take into account the variance between opening and closing inventories, so as to match goods consumed to sales. The figure is global, and includes the cost of raw materials, production staff and, for example, depreciation of the production equipment.

The *gross margin* is the first level of profit measure in the income statement. It corresponds to the profit after direct or indirect purchase and production expenses. In the case of LVMH, for the period of reference, the gross margin increased only by 4.3 %, because of the increase in cost of goods sold. The latter represents 35.2 % of sales, compared with 34.4 % respectively one year earlier.

*Marketing and selling expenses* are usually significant in the luxury industry, and are related to advertising and creating and maintaining an image. They represent a far higher proportion of sales than in other industries. Consistent significant spending on marketing will build up the image and, as a consequence, the value of the brand. In the case of LVMH these expenses are even higher than cost of goods sold, and represent around 37–38 % of sales.

*General and administrative expenses* cover other operating expenses during the period, such as those of the finance, legal or human resource departments. They are often referred to as overhead expenses. In the case of LVMH, they represented 8.7 % of sales in 2014, having slightly increased that year, which is not a positive factor as it reduces profit margins. Maintaining costs at a low level has positive effects on performance. But this should be done with precaution, so as not to hinder long-term growth perspectives.

*Operating profit* measures the firm's profit originating from its true business activity; it subtracts all operating costs from revenues. Comparing it with sales is an interesting way to benchmark against other industries. In the case of the LVMH, even if significantly lower than in 2013, the operating margin is a relatively high 17.7 %; this is characteristic of luxury industry leaders.

In the luxury sector, cost of debt is usually lower than in most sectors, as the companies are often family owned and very conservatively managed. This is the case for LVMH, with cost of debt in 2014 at a marginal 0.4 % of sales.

In 2014, LVMH recorded exceptional financial revenue linked to the capital gain it made on the Hermès International shares in which it had invested. This gain of more than €3 billion is considered as an extraordinary or non-recurring item, but of course contributed to LVMH's 2014 profits.

The last type of expense used to determine net profit is *tax*. This corresponds to the income tax the group pays on its earnings. To measure the average tax cost for the year, one compares tax with earnings before tax. In 2014, average tax represented 27 % of profit before tax. It is lower than that of the preceding year (30 %), due to a reduced rate on the capital gain realized in 2014.

The bottom line represents *earnings after tax*, also called net profit or net income. In case of a loss, a negative amount will appear: expenses being higher than revenues.

Because of the double entry accounting system, the profit after tax for the year also appears on the balance sheet, as part of shareholder's equity. An interesting profitability ratio compares earnings after tax to sales (it is called the net profit margin). In the case of LVMH, in 2014 it stood at 19.9 %, which was exceptionally high (linked to the Hermès capital gain). A level of 10–15 % is frequent in the luxury industry, and is often higher than in other sectors.

## Interpreting the LVMH Group Cash-Flow Statement

Any firm spending more cash than it generates will encounter at first liquidity (respecting the payment of its short-term commitments and having cash problems) and then solvency difficulties (honouring on the long term its obligations). The ability to generate cash is essential for short- and long-term survival. Cash is king! Making profit is important, but is also essential for this profit to convert into cash.

The total net cash flow generated during an accounting period (such as a financial year, FY) should thus be analysed. It corresponds to the difference between total cash inflows and total cash outflows for the period, but also corresponds to the difference between the opening and closing cash position.

The cash-flow statement helps to analyse its sources, as shown in Table 4.3, with the example of the LVMH group statement:

As observed in Table 4.3, three major categories of activities contribute to changes in a firm's cash position: operating, investing and financing.

Cash originating from operating activities comes from the operating profit (revenues – expenses); this has to be corrected by depreciation, which has reduced operating profits but not entailed cash outflow. On the contrary, income tax, a cash outflow, should be deducted from the before tax operating profits.

**Table 4.3** Summarized cash flow statement of the LVMH group, 2014 financial year (in € millions)

| | |
|---|---|
| **Net cash from operating activities** | 4,607 |
| Of which operating profits | 5,431 |
| Increase in depreciation | 1,895 |
| Income taxes paid | (1,639) |
| **Net cash from investing activities** | (2,007) |
| Of which operating investments | 1,775 |
| **Net cash from financing activities** | (1,733) |
| Of which dividends paid | (2,055) |
| Net proceeds from borrowings | 307 |
| **Net increase or decrease in cash for the period** | 867 |
| Cash and equivalents at opening | 2,916 |
| Cash and equivalents at closing | 3,783 |

Investment activities, except for the resale of investments, usually entail cash outflows. This is the case for LVMH, which invested in more than €2 billion of operating assets in 2014.

Lastly, financing activities can be a net inflow or outflow. For LVMH, a net outflow is recorded, linked to dividends paid to shareholders. Borrowings make a small impact, with an inflow of €307 million (new borrowings exceeding repayments on past loans). Low debt financing is, as we saw, a characteristic of many luxury companies.

So what can we observe overall? In 2014, LVMH's cash position increased by €867 million, resulting mainly from operating profits, despite making €2 billion of operating investments and returning more than €2 billion to shareholders in dividends. LVMH is a cash generating group, to the satisfaction of its investors.

Cash flow is important when judging value creation, and analysts often use the concept of free cash flow, by deducting from operating cash flow the necessary recurrent fixed asset investments. As we will see in Chapter 10, this concept is also used for brand valuation, where future free cash flows are discounted to determine their present value.

### A More Detailed Analysis Using Adapted Ratios and Other Key Indicators

As we have seen, financial statements give direct, interesting information on a firm's financial status and performance. But additional information is necessary. Corporate finance analysts have thus designed indicators that enable a more in-depth analysis of performance and value creation. These cover avoiding liquidity squeezes, measuring operational efficiency, judging capital structure and solvency, determining the firm's return on investment (and that of shareholders) and evaluating share performance.

## Assessing the Firm's Liquidity Status

A firm must be able to meet its recurrent obligations to its creditors (bankers, suppliers, etc.), and avoid illiquidity and bankruptcy risk. A firm's liquidity is often analysed through the structure of its balance sheet (composition of its assets and the way they are financed).

The basic strategy for financing a firm is called the matching strategy: long-term assets (fixed assets, investments), should be financed by long-term funding (equity or long-term debt). The reasoning is that long-term uses often involve significant amounts, and their returns take time. Thus, they can only be paid back over the long term.

Short-term needs can be financed by short-term financing. Inventories, accounts receivable (amounts due from customers), are cashed in with time lags and should be funded with the credit given by suppliers (accounts payable) or other operating creditors. However, the levels of current assets (inventories, accounts receivable, cash, etc.) are often higher than the level of current liabilities (accounts payable, other creditors) and sufficient long-term funding is always needed to finance the operating activity of the firm.

Companies should thus dedicate part of their long-term funding (over and above what is needed to finance its non-current assets) to financing the excess of current assets (excluding cash) over current liabilities. If long-term funding is insufficient, the firm will encounter liquidity problems.

The liquidity position is thus measured by two sets of ratios:

$$\text{liquidity ratio} = \frac{\text{long term financing} - \text{noncurrent assets}}{\text{working capital requirement}}$$

working capital requirement = current assets (excluding cash) – current liabilities

The idea here is to see whether the long-term funding excess corresponds to the operating activity requirement. If it does not, the firm will not be able to honour its obligations, unless it obtains short-term funding, from its banks, for example.

In the case of the LVMH group for 2014, this gives:

Current assets, net of cash (18.1–4.1) – current liabilities (12.2) = €2.8 billion, an excess, which is conservative.

$$\text{Current ratio} = \frac{\text{current assets}}{\text{current liabilities}}.$$

In the same spirit as in (a), we will be looking to see whether the current assets will be able to cover the current liabilities.

An excess of assets is, of course recommended, with sufficient cash and equivalents, in case inventories are held longer than expected or, for example, customer payments are received later than planned in the credit terms that had been negotiated with them.

In the case of LVMH, the current ratio comes to 18.1/12.2 = 1.48, which means short-term assets cover 1.5 times short-term liabilities, which again is conservative. The current ratio is often completed with more stringent ratios, which exclude certain categories of assets (such as inventories or accounts receivables). LVMH is thus in a highly satisfactory cash situation, with sufficient cash reserves to face possible liquidity squeezes. Some could say their position is far too conservative, as cash brings lower returns than operating returns. But this prudence is often the case for family luxury companies, and for this sector, which usually, as noted, comprises big cash generators.

## Measuring Operational Efficiency

Three factors influence a company's liquidity: the level of long-term financing, the amount of non-current assets to fund and the need for working capital.

Insufficient working capital will entail cash problems, but excessive working capital will impact performance, as funding has a cost (the return expected by shareholders or interest on the long-term funding required).

Decisions relative to the amount and nature (equity or long-term debt) of long-term financing, and to investments in fixed assets or in acquiring activities, are strategic by nature. They will be decided in the context of the firm's long-term planning.

Any decisions concerning the firm's working capital are linked to the management of its operating cycle: decisions should be taken as to the level of the current assets and liabilities and inventories; credit terms must be negotiated with clients for the projected level of accounts receivable; and credit conditions need to be concluded with suppliers. The nature of a firm's business, the technology used in the economic sector and the level of sales all affect the level of working capital. Even in the luxury industry, the length of the production cycle, the type of distribution (with owned retail stores, or with third party distributors) will influence the funding requirement. But the amount of working capital required also depends on efficient management of the balance sheet items concerned. To ascertain the optimal levels, what ratios should be used?

The best overall ratio is certainly working capital requirement/sales. It is a good benchmark in a sector, even if one has to be prudent, because different firms can have different strategic or activity features.

In the case of the LVMH group, the calculation gives 2.8/30.6 = 9.1 % of sales, or 33 days of sales, a comparatively low figure.

However, three other ratios enable a more in-depth analysis of the working capital requirement:

*Inventory turnover* through the ratio: cost of goods sold/inventories (at closing or as an average for the year). It evaluates the efficiency with which inventories are managed. In the case of LVMH, the ratio for 2014 comes out at: 10.8/9.475 = 1.1, which means that overall stock turnaround is close to one year. This figure is comparatively high. It results from the

fact that LVMH's activity includes wines and spirits, such as Cognac or Champagne, which have a very long ageing inventory cycle. This is less the case with Louis Vuitton bags or Christian Dior perfumes! A detailed calculation by activity should thus be made.

The faster the inventory turnover, the lower the need for financing and the faster stock is converted into receivables or cash.

*Average receivable collection period*: this is obtained by dividing accounts receivable by average daily sales. It shows how long it takes for sales to be recovered as cash. Of course, this depends on the credit terms, but here again, the faster the better. For LVMH, the figure for 2014 is 27 days (2274/30638 × 360, days), which means that it takes LVMH on average 27 days to recover sales from its customers.

*Average supplier payment period*: this is to purchases what the average receivable collection period is to sales. The ratio is thus: accounts payable/average daily purchases. The level of purchases can often be obtained from the notes that accompany financial statements (if the information is not available, analysts often use the figure for cost of sales). LVMH does not publish the figure for purchases so, with cost of sales, the ratio is: 3.6/10.8 = 33.3 % of a year. This means that suppliers are paid by the company on average after 120 days. This should be compared with the credit terms negotiated with suppliers, but usually the longer the better, because it will reduce the firm's need to finance its operating assets.

## Assessing Capital Structure and Solvency

A firm can encounter a risk of insolvency through the contractual obligations of interest and capital repayment that accompany debt. Equity financing, for which investors are fully at risk, has non-contractual obligations. Investors are fully at risk for the dividend return (the firm has to generate profits, and decide to distribute them), and for the repayment of the capital invested. A firm is considered globally solvent, when its assets are superior to its liabilities. The higher the equity, the more solvent the company is, because in case of downturns, it will be able to absorb potential losses. Equity thus plays the role of "shock absorber" and the greater the equity, the more resistant the firm will be. But equity has a

cost. When shareholders bring equity, they expect a return; and if they are dissatisfied, they will complain to the firm's management.

Analysing the capital structure is thus essential to measure its insolvency and thus bankruptcy risk. Three ratios are most often used:

The *long-term debt ratio* compares the level of long-term debt with equity (long-term debt/shareholder's equity).

Often, for prudence purposes, it is considered that a 1/1 level is the limit: long-term debt should not surpass the investment made by shareholders. Debtors do not want to take a greater risk than the owners! But indebtedness, called leverage, has an advantage, it is tax deductible and if not too costly can have a positive effect on shareholder returns (in finance this is called the leverage effect).

For LVMH, the ratio is: 5.1/23 = 22 %, which is low. This is often the case for family-owned luxury firms, which are very conservative and do not play with financial risk.

The *leverage ratio* compares total assets with equity and, with regard to solvency, the higher the better. In the case of LVMH the ratio is 53/23 = 2.3, which in comparison with other firms is low.

To ensure that interest will be paid in the future, analysts calculate an *interest coverage ratio* (also called "times interest earned"). This ratio compares earnings before interest and tax (operating profit) with interest costs—the higher the multiplier, the better. In the case of LVMH we find a multiplier of 35 in 2014, which is very high, confirming the low indebtedness and thus conservative financial risk profile of this luxury group.

## Assessing the Firm's Returns

Every manager and financial analyst has his or her preferred ratios for measuring profitability. They all divide a level of earnings by an adapted denominator, depending on the user's aims. We will limit ourselves to those most used in the luxury industry.

First of all, *return on sales (ROS)*: the usual calculation is earnings after tax/net sales. It measures the net profit, after all expenses generated by €1 (or $1, etc.) of sales. It is a useful indicator for salespeople. LVMH, was

close to 20 % in 2014, which is a very high figure for the sector. However, it was also impacted by the exceptional earnings recorded by the group that year, linked to the capital gain on the Hermès international shares. A more frequent return level would be that of 2013 (13.6 %).

*Return on Assets (ROA)*, computed through net earnings/total assets, measures the efficient use of the firm's assets. It calculates how much profit is produced by €1 of assets—the higher the better. It is thus advantageous to invest in fewer assets to generate the same amount of profits. Luxury industries (except when they have a systematic strategy of brand acquisitions) require comparatively low fixed asset investments, and have thus higher ROA than other sectors. For 2014, LVMH had an ROA of 11.5 %.

Some analysts consider that the denominator total assets is too broad, and prefer computing a more operational ratio called *return on invested capital (ROIC)*. It is equal to operating profit (or EBIT)/invested capital, where invested capital = cash + working capital requirement + net fixed assets. This ratio has the advantage of linking operating profit to capital employed. For LVMH, the ROIC for 2014, cames to: 5.4/4.1+2.8+13+8?8+10.4) = 13.8 %.

Shareholders are even more interested in the return they obtain on the amount they have invested in the company (either initially or through the sums added or maintained via retained earnings). *The return on equity (ROE)* ratio is thus computed by the following formula: net earnings/shareholder's equity. It is the most used ratio throughout industry. However, it is based on accounting figures and not on market values. The true return for a shareholder uses dividends, share market price and potential share resale price.

For LVMH, ROE stood at 14.1 % in 2013 and 26 % in 2014, because of the extraordinary gain recorded.

ROS, ROA and ROE are based on financial accounting data, which are biased by using historical accounting cost. The principle of conservatism often applies, which reduces the value of the assets or the owner's equity. Another set of profitability ratios combine financial statement information with market data and determine stockholder return and share valuation better: these are the earnings per share, price earnings, dividend yield or market to book ratios.

*Earnings per share (EPS)*, determined by dividing earnings after tax by the number of shares outstanding, is a measure of the contribution of each share to profit, earnings being allocated either to dividends or to retained earnings.

Earnings per share is used to compute the *price to earnings ratio (PE)*. The PE is calculated using the following formula: share price/earnings per share. It corresponds ultimately to the number of yearly earnings represented in the share price. For LVMH, with 507.7 million shares outstanding, the price earnings ratio for the year 2014 was 132/(6.105/507.7 shares) = 11.7. This PE is exceptionally low for LVMH, due to the firm's exceptional earnings. The 2013 PE was more normal for LVMH, being in the low 20s.

If one is to determine the yearly share return as regards dividend payment, one computes the *dividend yield* by comparing the yearly dividend to the share's market price. This yield shows how much the shareholder receives in dividends. It is computed using the following formula: yearly dividend/share price. Some investors attach great importance to this return, while others attach more importance to the capital gain they will obtain if the share's market price increases.

In the case of LVMH, the dividend paid in 2015 out of the preceding year's profit was €3.23. For an average share price in 2014 of €132, this gave a dividend yield of 2.4 %, a typical percentage for multinational groups.

The final commonly used ratio is the *market to book* ratio. It is defined as share price/book value per share, where book value per share is equal to shareholder's equity divided by number of shares outstanding. Most often, this ratio is greater than 1, the fair value of the assets being higher than that given in the balance sheet, which is recorded at historical cost. However certain firms, will have a ratio inferior to 1, if the market considers that they are underperforming or highly risky. For LVMH, the book value per share comes to €23,003 billion/50.7 million shares = €45 and with an average share price of €132, market to book ratio comes to 2.9, due to the under-evaluation of certain brands bought at low prices and developed, or of new brands developed internally by the LVMH group. The market to book ratio is often high in the luxury industry, because of the internally generated image and high profitability. In the

case of Hermès, the share market price at the end of 2015 was nearly seven times that of book value.

## Conclusion

Financial value creation in the luxury industry is most often analysed or presented in their financial communication, using the same key indicators or ratios as for firms in other sectors. However, as we have seen, certain specific characteristics are encountered that mark out luxury companies from industrial or other commercial firms.

First of all, value creation in the luxury sector can be assimilated to the development of brand value, as the brand, and other intangibles such as goodwill, represent the majority of assets in the luxury industry, whether they appear in the balance sheet (in the case of acquisitions) or not (in which case they will appear in the firm's market value).

Apart from in certain specialized sectors such as Champagne, wine and spirits, or automotive (Rolls-Royce or Ferrari!), fixed assets and inventories are usually lower than in other industries, especially when brands have been internally generated.

Successful luxury firms benefit from significant export levels, which can reach 90 % of total sales. They also benefit from high margins. The cost of sales represents a far smaller percentage of sales than in other industries, and gross margins are often between 60 % and 80 %.

Marketing and advertising expenses are high. They can be similar to the cost of sales. Creating an image is expensive, and it is essential to maintain the image through advertising, flagship stores, events, etc.

In spite of these expenses, operating profit margins are high, in the 10–25 % range, with a high ROA.

Most luxury firms have low debt levels, with significant equity and reasonable long-term debt. Interest costs being low, net profit margins and cash flow generation are significantly higher than for other commercial firms.

Higher profits and low financial risk generate good share values, with high price to book ratios and high price earnings.

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# Part 2

## Key Assets and Competencies for Value Creation in the Luxury Company

# 5

# A Narrative Approach to Luxury Brands

Fabrizio Maria Pini

In contemporary markets the consumption process is no longer oriented to a simple functional satisfaction of consumers but becomes meaning-based as brands are considered to be symbolic resources supporting the construction of customers' identities (Elliot and Wattanasuwan 1998). If management's and consumers' goals for specific brands do not coincide, consumers would ignore or pay minimal attention to brand communications; little learning would occur and the goals of management would not be realised. As depicted in postmodern marketing approaches and ethnographic researches, consumers are engaged in symbolic projects (Elliott and Davies 2006), defining and maintaining identities in transformation out of symbolic materials where brands play the most crucial role (Goffman 1959; Grubb and Hupp 1968). Authors such as Featherstone (1991) support the idea that a new form of identity is emerging in consumer cultures: "The Performing Self which places greater emphasis on appearance, display and the management of impressions".

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More recently, the idea of a consumer characterized by a constant quest for identity transformations has been expressed by McCracken (2015). This search for new transformational values was enhanced by: (i) deep cultural changes in society. As stated by Firat et al. (1995) "The ability and willingness to (re)present different (self-)images in fragmented moments liberates the consumer from conformity to a single image, to seeking continuity and consistency among roles played throughout life, and the postmodern generation seems ready for such liberation"; (ii) technological innovations: "New technologies also allow the establishment of new, more participatory on line experience. It was now possible for people to 'become someone else' on line". In this ever changing scenario, where consumption practices are tightly linked to deeper cultural and individual dynamic meanings, the role of brands becomes increasingly and dramatically complex and articulated.

Luxury brands, in this context, show rich identities that are co-created with customers. The relationships that these brands create with customers are characterized by many points of contact where dialogues take place and storytelling is generated and shared. This approach to branding has its roots in postmodern marketing as a strong opposition to traditional marketing models (Firat and Venkatesh 1993). The postmodern approach to marketing has played a crucial role in re-interpreting the role of brands in marketing strategies and the relationship between brands and consumers, and could be applied to luxury brands and their complex deeply culturally-rooted identities. The postmodern approach to branding calls for a relevant evolution in the communication processes that move from company generated monologues to company–customer two-way communication flows that are mutually constructed with a broad societal orientation where brand owner and brand users co-create meanings.

## The Evolving Nature of Brand

The different approaches to branding and the managerial and consumption implications are well depicted in Goodyear's model (1996). In this six-stage model, the first four stages describe the classical approach to brand marketing, while the last two show the contribution of postmodernism to branding (Brown 1995). The six stages together show the changes in

branding practices in a product category over a sort of branding cycle. When the product is new, companies attempt to explain what the product is, how it works and why it can benefit the functional needs of consumers: this stage is called "brand as reference" in the model, in which management tries to differentiate brand through functional appeals and product attributes. When a brand can no longer differentiate using functional benefits for the presence of strong imitation pressure from competitors, management may decide to build a personality for the brand ("brand as personality" in the model), adding emotional benefits to the functional ones (Park et al. 1986; Gordon 1991). As the brand becomes well known worldwide, it may become a symbol or icon. In postmodern marketing, the brand may be the company or align itself with social causes. The way the brand passes through the different stages is strongly related to the willingness of consumers to respond to the branding efforts of managers as well as the readiness of managers to try new branding strategies.

## Stage 1: Unbranded Goods

In this stage, goods are treated and perceived as undifferentiated and most are unbranded. Usually the demand for the product category is higher than the availability. Producers make little effort to distinguish/brand their goods, with the result of a utilitarian consumer perception of goods. Many authors associate this stage with commodities but such a situation may also apply to luxury products, especially in the food industry: truffles are a good example of this approach to branding as they are very precious and rare to *gourmets* but totally unbranded; similar examples could be related to food products coming from a specific geographic region, which are identified for this characteristic and not for the manufacturer's brand (i.e. Parmesan cheese, Chianti wine, etc.).

## Stage 2: Brand as Reference

Competitive pressures induce organizations to differentiate their goods from the ones of other manufacturers. Differentiation is achieved primarily through changes in physical product attributes and the associated functional benefits. This primary source of differentiation

calls for a change in the way customers perceive products: they have to constantly expand their knowledge of products and services to formulate decisions based on overall quality, performance and features. All these aspects were in some way neglected in stage 1. The name of the producer is perceived as a synonym for superior or differentiating quality and is used to select the different options available on the market. Superior craftsmanship and manufacturing skills have been a characteristic of luxury markets for a long period of time. Fabergé eggs or Stradivarius violin stand are unique, incredibly valuable products for the skills required to create such products were in the hands of very few artisans.

## Stage 3: Brand as Personality

Differentiation based on few functional characteristics becomes increasingly difficult in mature markets, where competitors might all formulate similar claims. To overcome this situation brands started to incorporate traits of the consumer (personality). The incorporation of human traits in the brand increases its appeal through the cultural representation of desirable personalities. Consumers' and brands' personalities tend to merge in this stage and there is an active engagement of consumers in the "right" use of brand for self-expressive purposes. Brands stand for deep and rich meanings and customers devote a relevant cognitive effort to decoding brand signs. In fashion and luxury markets this approach to branding is filtered through the role of designers (who become icons of the lifestyle they want to represent) no longer showing mere craftsmanship and technical skills but a personal view of elegance and beauty, proposing a brand for consumption that represents a lifestyle and a specific personality. Ralph Lauren brand represents a classic image, and a traditional American lifestyle. It might be noted that it is not a brand with a long heritage (it was founded some 40 years ago), but one that offers customers a contemporary vision of what is perceived as a "classic American lifestyle" re-interpreting and accentuating symbols and meanings to create a plausible personality that might appeal to customers. Ralph Lauren himself, like Giorgio Armani for the Italian fashion industry, has become an icon and living symbol of the lifestyle that the brand represents.

## Stage 4: Brand as Icon

In this stage of the branding development, the brand is "owned by consumers" (McEnally and de Chernatony 1999), who use it to create and modify their self-identities. In a postmodern vision of consumption, brands as well as products are likely to become less and less a "finished" object devoted to passive acceptance and consumption by users and more and more a process into which a consumer immerses oneself and activates co-creative activities. To acquire a top of mind position, iconic brands should present complex identities, often related to the interpretation of social and group values through brand signs. In this sense, "consumers use marketing communications to actively seek out personal meanings (McCracken 2005) through the use of brands, meaning is of course dependent upon the cultural context within which consumption occurs" (Dahlen et al. 2005). In this sense, Smith (2007) defines *individual brand congruity* as the way in which consumers adopt salient identities projected by communications that resonate with their idea of self-image and adapt them to individualized various persona.

## Stage 5: Brand as Company

This stage shows a radical change in the way relationships between brands and consumers are created. The origin of the cultural meaning of brands is no longer located within the marketing department boundaries, but is placed in the culturally constituted world, outside the organization and its marketing efforts. Marketing re-interprets this meaning and, together with other social pressures and phenomena, embeds it in products and most of all in brands for individual consumption through set of rituals, such as the purchase.

Brands show complex identities and develop conversations with customers through a large and ever growing number of touch points. All stakeholders contribute to the co-creation of the brand identity and the need for an integrated approach to communications is strategic for a brand's success. Postmodern consumers seek a narrative upon which to base their identity: the growing need for a deep and immersive relationship with

the brand calls for a new set of media to support extended narratives. The traditional means of communicating marketing messages has been based on the transmission of ideas through single channels rather than a consistent message through different media. In contemporary markets, customers actively use different kinds of interactive and traditional media to develop their relationship with the brand. In this sense a media-neutral planning recognizes how customers access media contents in a multi-channel and fragmented media world. Similarly, transmedia planning refers to the development of a single nonlinear brand narrative replicated across brand touch points in order to create brand communities, in turn accelerating word-of-mouth. Customers, in this stage of branding, are more active in the creation of brand meanings and they embrace conversations about the brand, not only in touch points controlled by the brand itself but also in groups and communities away from brand's reach. Within these new conversation spaces, new subjects (influencers and peers) become relevant sources of information about the brand and locate the brand in the proper cultural context for attention and adoption. Consumers are co-creating brand value and identity and, by doing so, they are tailoring the brand to individual and group needs. In classic brand building, the company took the initiative in creating the brand's personality and functional characteristics, while in the brand as company stage, consumers interpret brand's meaning, adapt it to their own uses and in so doing create value. In this scenario, the primacy of the company in managing and delivering the proper brand image is challenged by the direct contribution of different stakeholders to the meaning-making process. This change in the way brand identity and brand value are generated and perceived requires relevant changes in the way companies manage their communications processes, in particular: (i) a larger set of communication tools to support engagement and customers' involvement becomes necessary to foster dialogue; (ii) a larger involvement of employees at all levels in the communication process and in the relationship with stakeholders (King 1991; de Chernatony and Harris 2000). Riders communities of Ducati, the Italian high-end motorbike producer, contributed actively and extensively to brand identity construction. As stated by former Ducati CEO: "I also realized that we don't actually have customers. All we have are passionate fans, Ducatisti! When I look at our

fans, I cannot find any good ways of segmentation. Maybe the only thing they have in common is Ducati. I can think of them as a tribe in a village: it does not matter who they are, the link between them is the object they love and are passionate about. We used every opportunity to engage our fans in racing. In the Ducati tribe, what is important is not winning, but fighting together. We make them feel as if they are fighting and winning with us" (Boaretto et al. 2007).

## Stage 6: Brand as Policy

In this stage, brand identity is enriched by an alignment with ethical, social or political causes, strengthening the bond with customers that implicitly support the cause through brand consumption. The identity of the brand is generated through the interaction of social groups, individuals and marketing agents that frame the position of the brand in relation to the cause it supports. The level of transparency and interaction requested to the brand in this stage is very high as the support of a social cause has an impact on the whole organizations and its processes. Sustainability has long been a key issue for luxury brands which have often been accused of promoting a style of consumption and producing products that could be harmful under many aspects for the environment and local communities. Despite the relevant efforts that luxury brands undertook recently to please more environmental friendly consumers and stakeholders, sustainability is not, in general terms, a determinant part of brand identity. A positive example of brand as policy can be identified in Stella McCartney, a luxury brand belonging to Kering Group, which follows its founder's individual interests as an activist on sustainability. McCartney's approach towards sustainable fashion comes from her own conviction. When the company was founded, everything was based simply on instinct and the personal values that she, a life-long vegetarian, had grown up with. The brand does not use any animal products in its collection: no furs, no skins, no feathers and no leather. Here sustainability is the core competitive weapon: Stella McCartney uses sustainable development as her positioning before being a luxury brand (Kapferer and Vincent 2012).

In the model of branding evolution presented here it is possible to see a significant shift in the way brands are managed when passing from the first four stages of the branding model to the last two. In the first four stages: (i) brand meaning and brand identity are created by the company through the autonomous decisions of managers; (ii) identity is then proposed to customers for adoption in order to serve their expressive needs. In the last two stages, on the contrary: (i) brands "adopt" and "translate" pre-existing, external values that are already embedded in society; (ii) brands then become vehicles that customers can use to move meanings for their individual and collective purposes; (iii) by doing so, brands become cultural objects whose meaning and identities are co-created through the participation and involvement of customers, internal and external stakeholders, groups and communities. The postmodern approach to branding calls for a relevant evolution in the communication processes that moves from company-generated monologues to company–customer two-way communication flows that are mutually constructed with a broad societal orientation where brand owner and brand user co-create meanings.

## Storytelling and Brand Narrative Models

Postmodern consumers are engaged with brands through a narrative process upon which they can base their identity. This process is developed through conversations that take place through many different media and touch points. In this sense, the more communications turn into conversations, the more traditional forms of company "monologues", such as mass media advertising, become obsolete and unable to establish long-term relationships with customers. The growing need for deep and immersive relationships with the brand calls for a new set of media to support extended narratives. In contemporary markets, customers actively use a rich combination of interactive, digital and traditional media to develop their relationships with brands. The intensity of the relationships with brands is strongly related to the set of self-expressive, identity-building meanings that brands carry in their co-created identity. The increasing relevance of symbolic meanings of brands is strongly associated with

the experiences that customers have during rich interactions with them: experiential consumption is tightly related to the notion of consumers manipulating signs and symbols in the marketplace in order to communicate with those around them. Customers' interactions with brands are, in this sense, part of a comprehensive conversation about the definition or modification of self: the growing demand for authenticity (often interlaced with the notion of heritage) in brands and products could be explained by the need of customers to define "real" or "true" identities: "People increasingly see the world in terms of real and fake, and want to buy something real from someone genuine, not a fake from some phony." (Gilmore and Pine 2007). Luxury brands' narratives, in this context, show obsession for real attachment to a place, history, craftsmanship or uniqueness. Champagne *vignerons* that highlight their generational belonging to the same territory and the same processes of transformation and the hand-bent bamboo handle of a Gucci bag, both belong to this complex narrative of "real" luxury that shares similar bonds to "real" traditions, sites and/or productive practices. In this context authentic iconic luxury brands are often the ones that show stronger local ties (country of origin effect) or sounder historicity (designer heritage).

The increasing amount of time and effort that customers spend in establishing multi-channel and multi-media conversations and interactions with brands is dependent on the fact that they expect more experiences from the brands they buy, experiences that also link them to other like-minded consumers. In this sense, rather than being interested only in the functional and self-expressive values of brands, postmodern consumers look for a "linking value" (Cova 1996) with similar consumers, groups and communities that share the same interests, approaches and ideas. An experiential consumption perspective conceptualizes consumers as socially connected subjects rather than simply as individual and atomized purchasers of a product or service. These subjects "activate and enliven a social process of commercial meanings and identity production–consumption" (Cova et al. 2007) often through relationships with other members of consumer tribes. The role of digital media, that allow a proliferation of touch points and interactions among different subjects and identities, is of primary importance in the process of tribalization of consumption:

> People are retribalizing in cyberspace: they are E-tribalizing. Networked computers empower people around the world as never before to disregard the limitations of geography and time, find another and gather together in groups based on a wide range of cultural and subcultural interests and social affiliations. Because many of these affiliations are based upon consumption activities, these E-tribalized groups are of substantial import to marketing and business strategists. (Kozinets 1999)

In this complex scenario, brands could be defined as cultural narrators (Hirschman 2010; Woodside 2010) that engage customers and organizations in an ongoing conversation and co-creative process in which the company only partially controls the narrative (Visconti 2010). This calls for an evolution in the role of brand managers who should be part of a "multilogue" (Berthon et al. 2007) and "attend to, and leverage, a 'symphony' of old and new brand meanings" (Diamond et al. 2009). The narrative skills required by brands are originated from the construction of nonlinear, multi-layered stories that can adapt to different publics. Diamond et al. (2009) strongly opposed the established principle of integration and consistency across brand elements (Keller 2008) as the key to branding success, suggesting that complementary narratives can outperform integrated and consistent brand elements by generating significant synergies across the single constituents of what they call "brand Gestalt". This approach to brand storytelling is tightly linked to the construct of transmedia stories, that could be defined as "stories told across multiple media. At the present time, the most significant stories tend to flow across multiple media platforms" (Jenkins et al. 2006, p. 46).

In the ideal form of transmedia storytelling, each medium does what it does best—so that a story might be introduced in a film, expanded through television, novels and comics, and its world might be explored and experienced through game play (Scolari 2009). The structure of transmedia storytelling is such as to allow expansion through the use of different media-specific languages: in this sense, transmedia is not the mere adoption of a content to the characteristics of a specific media. The story that the brand tells on a television advertisement is not the same as the one told on a YouTube channel, the brand website or Twitter; the different media, channels and languages participate in and contribute to the construction of the transmedia narrative world.

## Brand Narrative Models

Among the possible sources that could provide a definition of a "good" story, probably one of the most comprehensive and simple is the one that can be derived from classical drama and myth creation:

> Stories are a particular type of human communication designed to persuade an audience of a storyteller's worldview. The storyteller does this by placing characters, real or fictional, onto a stage and showing what happens to these characters over a period of time. Each character pursues some type of goal in accordance with his or her values, facing difficulty along the way and either succeeds or fails according to the storyteller's view of how the world works. (Sachs 2012)

Consumer storytelling is tightly connected with the notion of myth. Holt (2004) proposes that some brands become iconic (not in the sense presented in the part of this work related to the Goodyear model), allowing consumers to experience powerful identity myths. This occurs when the brand becomes a "symbolic slave" (Holt 2004) permitting the transmission of the myth to the customer through the consumption process. Identity myths are created out of what Holt describes as populist worlds, that is, places that are separated from daily lives and economic or political control. These worlds and the people that inhabit them are the sources of credible myths, as they offer the notion of authenticity, grounded in the fact that real people, in these worlds, live real lives ruled by their own values and beliefs. These worlds might or might not be contemporary but are perceived as relevant and inherently "true" by consumers: using a symbolic language, myths allow people to break free of reality constraints and, at the same time, activate a transformation process. In the myth approach to brand storytelling, brand is perceived as a mentor, an agent that allows the consumer to undergo the transformation process into the hero that the myth supports: recognization one's own hero potential is what drives people to connect to the myth and become part of it. Myth narrative is built upon the idea of an individual transforming into a hero with the help of a mentor and the acceptance of answering the call for adventure that the story proposes. In this sense, myths give a rationale

and direction to how and why life changes. Following Sacks (2012) description a story begins with a situation in which life is relatively in balance in what could be defined as the ordinary world. But then there's an event: the call to action for the hero-to-be, that throws life out of balance. The hero-to-be might have to leave his job, or an important customer threatens to leave. At the beginning, the hero-to-be resists this call and it is only after the encounter with a mentor, who shows the way and confirms the correctness of the change, that the hero crosses the threshold and enters into the special world where things are no longer the same. In this new world the hero faces tests, defines alliances and discovers terrible enemies until he or she faces the ordeal. After winning the hero seizes the treasure for their struggle. After this epic challenge the hero takes the road back to the ordinary world bringing a boon with them (the morale of the story); that is the hero's contribution to the world. These phases complete what Sachs (2012) calls the hero's journey and could be identified in most of the myth narratives. A good storyteller describes how the hero deals with opposing forces, calling on the protagonist to dig deeper, work with scarce resources, make difficult decisions, take action despite risks and ultimately discover the truth (McKee 2003).

An alternative approach to brand storytelling derives from consumer psychology and psychoanalytic research on brands as archetypes (Hirschman 2000; Rapaille 2004; Zaltman & Zaltman 2008). Jung (1916/1959) defines archetypes as "forms or images of a collective nature which occur practically all over the earth as constituents of myth and at the same time as autochthonous (biologically based unconscious thinking) individual products of unconscious origin." Within each individual there is an archetype that is instantly recognisable to others and that rules our personality and the way we behave. In their book *The Hero and the Outlaw* Mark and Pearson (2001) describe 12 separate archetypes that could be applied to consumer brands: the innocent; the explorer; the sage; the hero; the outlaw; the magician; the regular guy/gal; the lover; the jester; the caregiver; the creator; and the ruler. Other authors suggest different archetypes and Jung himself was vague on the quantity and quality of the possible archetypes (he only focussed on the ones related to the mother, the father and the child). Campbell (1968) describes the following set of archetypes: the hero, the mentor; the threshold guardian;

the trickster; and the shadow. Other possible archetypes can be found in different contributions on the subject by both researchers and practitioners. The selection of a brand archetype (out of a wide range of options) offers clues to the narrative and provides a character model that might guide brand behaviour during the narrative process and the interaction with customers (Vincent 2002).

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# 6

# Financial Valuation of Luxury Brands

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In the past, tangible assets (manufacturing assets, land, buildings and financial assets) were regarded as the main source of business value. However, economic and market conditions in the last quarter of the twentieth century have shown that a company's value is not made up of its tangibles alone. Both markets and academia have recognized that intangibles are one of the main sources of value creation, and a factor in explaining the gap between some companies' market and book (or accounting) values.

Intangible assets include brands, research and development and patents. Brands are often the most valuable assets many luxury companies possess. However, measuring the brand value and value creation remains tricky. This chapter explains how luxury brands are valued from a financial perspective and how they add value to the company, while bearing in mind that valuation of luxury brands remains a task similar to valuation of any brand.

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Even when a company's market value (shareholder value) increases, brand specific contributions to this value remain unclear and difficult to quantify. Current accounting standards[1] continue to determine company value mainly using tangibles. The brand is rarely explicitly and adequately valued, and it does not appear often in financial statements. Even when it does appear, the figures do not have a universally recognized economic and market foundation, apart from the year of brand acquisition.

Brand value depends greatly on the position of the company that owns it. When no transaction is involved, the brand is valued as a function of accrued costs, or as a function of everyday usage. When a specific operation involves the brand, such as a company merger or acquisition, or litigation, the purpose of brand valuation will be different.

## Why Quantify Brand Value?

> "Brand valuation is at the heart of how brands create value" (Kapferer 2011).

Why value a brand from a financial perspective? Why try to quantify it in dollars or euros? In a context of mergers, acquisitions, brand management, financial accounting and reporting, brand portfolio evaluation, legal expectations and corporate strategy, the need to put a figure on a brand arises from diverse complex situations. A common mistake is to ignore the objectives, context and purpose when valuing a brand from a financial perspective.

For example, brands need to be valued in cases of litigation. The need for valuation is also found in a merger or acquisition situation, because it will help determine the price, and because the excess price paid by the raider company for the target company includes the value of the brands, and this value must be identified within the premium per accounting standards. For capitalized brands, the brand must be tested once a year for any loss in value that might occur.[2] Another reason for financial valuation of a brand is to calculate royalties or licenses. Finally, managers of a portfolio of brands must have an idea of their value when making

[1] See Chap. 4.

[2] IAS 36—impairment tests.

investment or operating decisions, when choosing between brands and when allocating assets.

Brand valuation has become sufficiently important internationally that the International Organization for Standardization (IOS) has published **ISO 10668** on this matter (2010). This standard specifies the principles and methods to be implemented in any brand valuation. It provides a three-step framework for valuing brands: (1) formulation of objectives for valuing the brand and study of contextual qualitative aspects: legal and behavioral analysis; (2) financial analysis; and, finally, (3) main approaches and methods to quantifying the value. In a nutshell, IOS considers brand valuation important enough to publish a standard about it (Fig. 6.1).

The monetary value of a brand calculated in step 3 in ISO 10668 is linked to costs incurred for brand development and to revenue generated by the brand. If we compare the use and valuation of tangible and intangible assets through an example, machines are used exclusively to manufacture one product in one place at a given time, whereas brands can be used at several places at the same time, their opportunity cost being close to zero. Marginal cost is also very low for brands. Even if there is often an initial sunk cost, additional production cost linked to brands is generally considered null. Also, costs linked to brand development are cumulative, where costs linked to the maintenance or repair of the machine are not.

And lastly, brands do not have organized markets whereas most tangible assets (and also many financial assets) have the possibility of exchange at arm's length. This is one of the most significant barriers to brand valuation.

When presenting brand valuation, we will concentrate on financial aspects and skip the evidently necessary first steps dealing with market analysis, customer perception, brand strength and other more qualitative aspects already explained in other chapters.

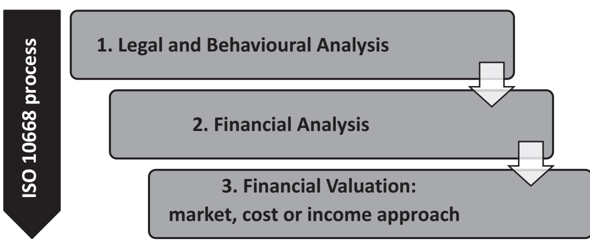


**Fig. 6.1** ISO 10668 – Brand valuation: methodology

## Financial Reporting Standards on Brand Recognition

The ISO standard 10668—brand valuation starts with legal, behavioural and financial analysis.[3] In a financial analysis, one of the issues related to valuing a brand would be to investigate whether the brand is one of the intangible assets on the balance sheet.

Under which conditions do financial reporting standards recognize the value of the brand in the balance sheet?

Unfortunately, there are almost as many accounting systems as there are countries. However, "international accounting" standards (IAS IFRS[4]) are widely recognized. Within this framework, brands can only be shown on the balance sheet if they have been purchased separately or in a business combination (e.g., a merger with or an acquisition of the company owning the brand). In the latter, when a company is purchased by another, the price paid for it is in most cases higher that the book value (or value of the net assets). How can we explain the difference between the book value and the market value? The first source is the revaluation of the assets identified in the balance sheet, both tangible and intangible. The second source is the identification of intangible assets (most often brands) not present in the balance sheet. The residual amount that closes the gap is called goodwill (Fig. 6.2).

Therefore, the rule for brands is asymmetric: internally-generated brands are not shown on the balance sheet alongside the other assets of the company, whereas purchased brands are.[5]

Moreover, subsequent to the purchase, the value of the brands on the balance sheet cannot be revalued upwards (only downwards if necessary). Brands are tested annually to search for any losses in value that might have occurred, and in order to perform this test the need for a financial valuation of the brand emerges again.[6] Anyhow, the capitalized brand value often becomes obsolete as time passes.

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[3] See Chaps. 4 and 7.

[4] International Accounting Standards—International Financial Reporting Standards.

[5] IAS 38—intangible assets.

[6] This is done annually through an impairment test (IAS 36).

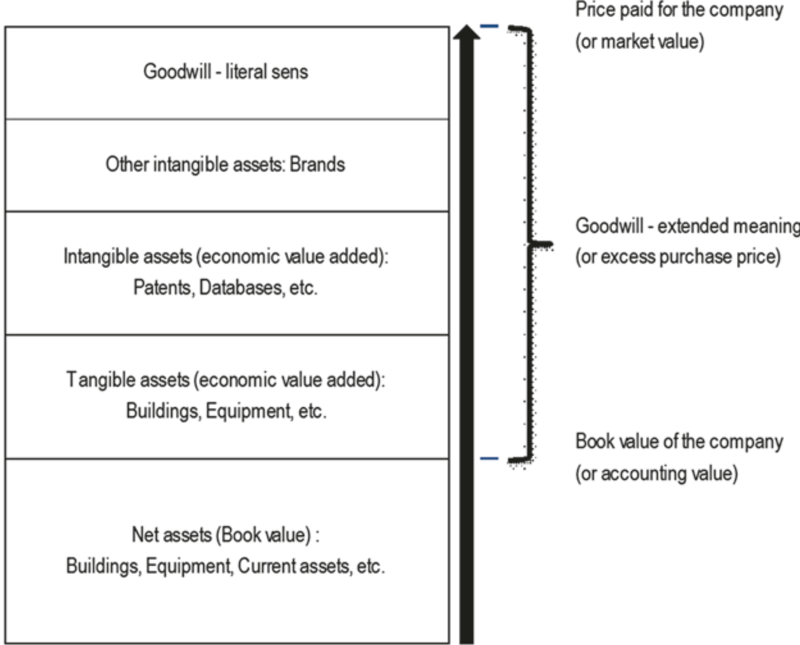


**Fig. 6.2** Sources of the gap between book value and market value (Adapted from J-N Kapferer, *The New Strategic Brand Management*, Kogan Page, 2011)

Even if only some of the brands are capitalized, for some companies, particularly in the luxury industry, the majority of the intangible assets on the balance sheet are brands. Take the LVMH group (discussed in Chap. 4), for instance. In 2015, brands made up 37 % of total non-current assets, whereas tangible assets represented 29 %. If goodwill[7] is also taken into account, brands and other intangibles represent 62 % of non-current assets. This highlights how in certain industries brands have become more significant than tangible assets.

Robin & Murphy (1991) explains reasons why a company would want to capitalize its brands. For example, if internally generated brands were recognized as assets, solvency would improve, because of the larger asset

[7] For any merger or acquisition before 2004, the brand value at the time of the operation is included in the goodwill.

base (i.e., the gearing ratio would be lower). The increased equity would show value creation for the shareholders. However, return on assets (ROA) would decrease, which would penalize those companies using economic value added (EVA™)[8] to measure value creation. The issue of recognizing internally-generated brands on the balance sheet will probably have to wait until a sound valuation method can be found.

## Variety of Approaches to Brand Financial Valuation

There are many different methods for valuing a brand, which can be grouped into three families. The methods are classics in the world of financial valuation. They have however been adapted to the specific case of valuing a brand.

Valuing something from a financial perspective means finding the theoretical price that would be paid in a transaction where both participants are well-informed (at arm's length).

I previously stated that there is no active market for brands to provide comparable values, unlike for other assets, such as stocks, bonds, commodities and real estate. Firstly, each brand is a unique intangible asset and, secondly, there is no physical or virtual place where parties interested in purchasing brands could exchange information and brands. In contrast, each share of a public company is the same as the next, and shares can be exchanged at a Financial Stock Exchange (i.e., Euronext). Therefore, a number of brand evaluation approaches have been developed over the last two decades. Basic approaches fall into three categories: income based, market based and cost based, as Fig. 6.3 shows.

Figure 6.3 is by no means comprehensive (Abratt & Bick 2003). There are other methods that I have chosen not to present.

The main approach to brand valuation is income based. The other two cannot be used alone, and are often used in tandem with the income-based approach to provide an alternative view.

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[8] See income split method in this chapter.

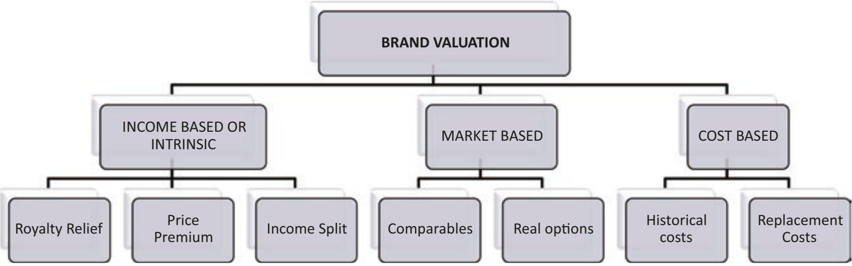


**Fig. 6.3** Approaches on brand valuation

The income-based approach calculates the present value of future cash flows or income generated by the brand. So, before introducing the three main methods (royalty relief, price premium and income split within the income-based approach), I will introduce the financial technique called "present value of future cash flows" or "discounted cash flows".

## Present Value of Future Cash Flows—Refresher[9]

The income-based or intrinsic approach relies upon a well-known method for calculating the value of an asset. This method is called discounted cash flows (DCF), which will be explained further.

How can one assess the value of a brand? By summing up the net, marginal, discounted cash flows generated by the brand in the future. In other words, the value of a brand is the additional money that the brand will earn for its owner.

"Discounted cash flows" is a strange notion.

Let's rephrase that: the value of a brand is the additional money that the brand will put in the pocket of the brand's owner.

What are DCFs? This can be best explained using an example: would you prefer me to give you €1000 today or €1000 in one year? Obviously you would prefer €1000 today instead of tomorrow. Why? Because there

[9] Inspiration for this section was found in J. Hoffman and I. Coste-Manière, *Luxury Strategy in Action*, Palgrave Macmillan 2011, Chap. 3 by Giulio Pizzini.

is a risk that I might not have the €1000 in one year. Or because you could invest the €1000 today and have more than €1000 in one year because you will have earned interest. We agree then that €1000 today is worth more than €1000 in one year.

Let's assume that a brand will generate €1000 today and €1000 in one year. We have to add those two numbers, therefore we need to calculate the current value of €1000 received in one year's time.

Suppose that I give you €1000 and you put it in the bank. It would earn maybe an annual interest of 5 %, making €1050. It follows that for you there is no difference between €1000 today and €1050 in one year. How did we calculate the €1050?

$$€1000 \times (1 + 5\%) = €1050 \text{ or } €1000 = \frac{€1050}{(1+5\%)}$$

$$PV \times (1 + R) = FV \text{ or } PV = \frac{FV}{(1+R)}$$

where:
PV or present value = 1000
FV or future value = 1050
*R* or discount rate = 5 %

Another possibility would be to invest it in a company instead of the bank. If the company is expected to pay a dividend of €150 in one year, thereby earning you 15 %, then it is a good deal. However, the company could go bankrupt, earning you nothing, and you may even lose the initial €1000. The rate that you use to calculate the DCFs is based on the perceived risk of the future cash flows (see Hawanini & Viallet 2011). Intangible assets are generally perceived as riskier than tangible assets (Lev & Zarowin 1999), so discount rates for brands will generally be higher.

The value of a brand is thus the present value of future cash flows generated by the brand. Now, for how many years will a brand generate money? Perhaps 20 years? Maybe 100 years? Forever? Brands have an infinite useful life, unlike most tangible assets, which have a finite useful life. To determine the value of the brand we would need to estimate future cash flows until infinity.

Now, we will forecast cash flows for the near future (let's say five years) and then calculate a terminal value that will capture all the cash flows beyond the horizon of five years. Of course it helps that as time goes by the present value of each cash flow becomes smaller, until their value is very close to zero. The present value of an infinite stream of future cash flows that grow at a constant rate can be calculated using the following formula (see Aaker (1991)):

$$PV \text{ of an infinite stream of } CF \text{ with constant growth}_0 = \frac{CF_1}{R-g}$$

Once the rate is determined, we can calculate the present value of future cash flows using the following formula:

$$PV \text{ of asset} = \sum_{n}^{t=1} \frac{CF_t}{(1+R)^t} = \frac{CF_1}{(1+R)^1} + \frac{CF_2}{(1+R)^2} + \frac{CF_3}{(1+R)^3} + \frac{CF_4}{(1+R)^4} + \frac{CF_5}{(1+R)^5} + \frac{CF_6/(R-g)}{(1+R)^5}$$

These cash flows (CF6 to ∞) will be captured by the terminal value

| Cash Flows | | $CF_1$ | $CF_2$ | $CF_3$ | $CF_4$ | $CF_5$ | $CF_6$ | $CF_7$ | $CF_8$ | ... | ∞ |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Years | 0 | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | | |

We are now ready to calculate the value of a brand as the sum of the DCFs generated by that brand in the future.

Below you will find the three most popular methods using the income-based or intrinsic approach: relief from royalties, price premium and income split.

## Relief from Royalties Method

This is one of the most popular methods used to value brands, and it is used by the BrandZ agency. The principle of this method is to add together all the money that someone is willing to pay for using the brand

when it is licensed. Adding up the stream of royalty cash flows would give us an idea of the value of the brand.

Some brands are licensed, some are not. For licensed brands, we add the royalties obtained from actual licensing. If the brand is not licensed, we try to estimate (guess?) the royalties for which we would agree to let someone else use the brand.

In the luxury industry, there are few licensed brands. So we need to ask what annual royalties (or license fee) could the company hope to receive if it licensed the rights to use the brand? We would then use this answer to measure the brand's financial contribution in sales, and calculate the DCFs over several years, assuming that a royalty license implies that the company to which the brand is licensed is responsible for local marketing and advertising. The royalty rate is a percentage of revenue made by the licensee and is paid to the owner.

Here is an example:

**Step 1**: Identify percentage of royalty rate on sales

Either the company licenses its brand and has the information, or find similar companies with comparable brands; databases provide this information.[10] The final royalty rate will be decided after taking into account qualitative aspects as well. Obviously, royalty rates are higher in the luxury sector.

For example, we are trying to apprehend the royalty rate for which brand L would be licensed. In Table 6.1, we have compiled several royalty rates used for brands similar to brand L:

**Step 2**: Forecast branded sales: 600, 650, 650, 680 and 690 over the next five years.

**Table 6.1** Table of royalty rates on comparable brands to brand L

| Comparable brands | A | B | C | D | E | Average |
|---|---|---|---|---|---|---|
| **Royalty rate** | 6.2 % | 6.5 % | 10.0 % | 9.0 % | 8.5 % | **8.0 %** |

[10] For example, www.royaltysource.com.

**Table 6.2** The relief from royalty method (steps 1 to 5)

| Years | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|
| **Brand revenue for 5 years (step 2)** | 600 | 650 | 650 | 680 | 690 |
| Terminal value (or perpetuity) **(step 3)** | | | | | 8884 |
| **Total brand revenue** | **600** | **650** | **650** | **680** | **9574** |
| Royalty rate **(step 1)** | 8.0 % | 8.0 % | 8.0 % | 8.0 % | 8.0 % |
| **Royalty income stream before taxes (tax rate = 40 per cent)** | 48 | 52 | 52 | 54 | 766 |
| **Royalty income stream after taxes (step 4)** | 29 | 31 | 31 | 33 | 460 |
| **Brand Value (step 5)** | **368** | | | | |

**Step 3**: Choose estimates: 3 % growth rate (for the terminal value) and discount rate 11 % (taking into account the risk of investing in the branded product). Then calculate terminal value of royalty revenue beyond five years.

**Step 4**: Apply royalty rate to brand revenue to calculate royalty cash flows. You might need to subtract marketing costs and you will need to subtract taxes to calculate the net royalty cash flow stream after tax.

**Step 5**: Discount the royalty income stream at the discount rate (using the previous formula) and find the net present value (brand value) (Table 6.2).

## Price Premium Method

The core assumption for this method is that a branded product will sell for more (a premium) than a generic product (Aaker 1991). The objective is to directly measure the price difference or price premium between a branded and a non-branded product. For example, a bottle of Moët Champagne will cost €30, and a similar bottle (with the same grape variety and vintage) of a non-branded Champagne will be priced at €14. The margin differential is €16.

Start by observing prices, taking into account any discounts. Then retrieve the full cost of each product, taking into account differences associated with the products: quality, packaging, conditioning, volume, whether it is hand-made, etc. Also take into account promotion costs such as marketing and advertising as they can be significant in certain luxury industries. This will give you the net margin attributable to the brand (see Table 6.3).

**Table 6.3** Price premium method—calculation of the margin attributable to the brand

| | Branded product | Generic product | Difference |
|---|---|---|---|
| **Net selling price** | 60 | 20 | 60 – 20 = **40** |
| Full cost | –20 | –3 | 20 – 3 = **17** |
| **Margin** | = 40 | = 17 | 40 – 17 = **23** |
| Marketing expenses | 9 | 0 | 9 – 0 = **9** |
| **Margin attributable to the brand** | 31 | 17 | 31 – 17 = **14** |

**Table 6.4** Premium price method: calculation of brand value using a price premium of 14€, growth rate of 3 per cent, discount rate of 12 per cent and tax rate of 30 per cent

| Years | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|
| **Volume (thousand units)** | 100 | 150 | 160 | 180 | 200 |
| **χPrice premium = premium sales** | 1400 | 2100 | 2240 | 2520 | 2800 |
| Terminal value (or perpetuity) (th €) | | | | | 32,044 |
| **Total premium sales (th €)** | **1400** | **2100** | **2240** | **2520** | **34,844** |
| **Taxes (th €)** | –420 | –630 | –672 | –756 | –10 453 |
| **Total premium sales after taxes (th €)** | 980 | 1470 | 1568 | 1764 | 24,391 |
| **Brand value (th €)** | **18,124** | | | | |

The margin attributable to the brand is the price premium. It will be applied to the future volume of products sold to calculate future cash flow. The present value of these future cash flows after taxes will constitute the value of the brand.

Future volume of activity should be estimated taking into account market and economic constraints. Also, the price premium will be calculated for each product type for each brand. For instance, a Grace Kelly bag and a bottle of perfume both from Hermès will not yield the same margin.

Then apply the same methodology as before: forecast the future cash flows as the number of units sold multiplied by the margin attributable to the brand (price premium), calculate the terminal value, deduct taxes and DCFs to calculate the value of the brand (Table 6.4).

Implementing the price premium method is sometimes difficult as this method requires access to internal information about costs, volumes and prices (Philippe, Paugham & Aguilar 2014). A generic product must also be found.

## Income Split Method

The income split method, also called profit split or excess earnings method, is also based on the present value of cash flows.

The brand is considered to be an asset, and as such is an element that will generate future profits with reasonable certainty. If, for instance, the owner wants to internationalize the brand, it will then generate more sales and profits and the brand will be more valuable. An asset has no value unless it generates profits from its use or sale. Before we go further, let's specify that this method involves separating and isolating income associated with the brand from the global net income of the company, which requires identifying the value creation cash-generating units. They are the smallest identifiable group of assets that generate cash inflow that are largely dependent on the cash inflows of a single branded product.

Implementing the income split method can be done within four steps.

The first step is to estimate future operating profits generated by the brand. This is usually done through the setup of a business plan including future volumes, prices, marketing and publicity expenses, etc.

Step two requires the calculation of the EVA™ for the brand. We calculate the EVA™ or excess earnings by computing the net operating profits after taxes left once the operating capital requirements have been served (tangible assets, intangible assets and working capital).

$$EVA^{\text{TM}} = \text{operating profit} \times (1 - t) - R \times IC$$

where:

$t$ is the tax rate

$R$ is the discount rate

IC is invested capital: tangible assets, intangible assets and working capital

Must EVA™ be attributed solely to the brand? Not really as other factors will influence the purchasing decision.

The third step is to attribute a brand weight to the excess profit. This is usually calculated by conducting qualitative studies with customers. This

percentage will then be applied to the annual EVA in order to calculate the excess profit attributed to the brand.

Given that the ultimate goal is to produce a discounted sum of future excess profits, we then use in step four the procedure that was introduced in the previous sections to calculate the terminal value and to discount these excess profits to the present day.

## Common Issues with the Income-Based Approach

The income-based approach relies on the present value of cash flows and added parameters, the validity and reliability of which will be discussed in this section.

Any forecast is by definition uncertain. Estimating future cash flows involves a great deal of subjectivity because, let's face it, we do not have a crystal ball. One could argue that cash flows are allegedly steadier and stronger in the luxury industry than in other sectors, they can then be forecasted based on past cash flows with greater reliability than for other sectors.

Another issue is the discount rate. The calculation of this rate takes risk into account and is based on accounting data, which are supposedly stable and robust.

A third issue is the growth rate used in the terminal value.

A fourth issue is the period over which we calculate cash flows (five years in all our examples) and terminal value beyond. Why five and not ten or fifteen years?

## Other Approaches: Cost and Market Approaches

Even though the income-based approach is considered to be more appropriate for brand valuation, two other approaches are also used as an alternative: they are the cost and the market approaches.

## The Cost Approach

This approach measures the value of a brand based on the sums invested in building the brand, or its replacement or reproduction cost. It is based on the postulate that an investor would not spend more on an asset than the cost of replacing or reproducing this asset.

I will focus here on the historical cost method, which values the brand by totalling costs incurred in building the brand.

It is considered a robust, but not very accurate method. The brand values produced by this method are among the lowest.

It also raises a number of issues:

- Over what period of time should we add the costs? Should we add up all costs since the brand's original launch (e.g., Coca-Cola 1887; Saint-Laurent 1958)? Does past advertising still have an effect today? For instance, some brands no longer exist.
- How can historical costs explain today's value of a brand? Do past costs guarantee the value of a brand today?
- Which costs should be taken into account? For example, advertising generates extra sales and brand awareness; how do we weight each part?
- The initial outlay for the creation of a brand does not always involve a cash outflow. For instance, Rolls-Royce relies on knowhow, quality controls and specific expertise, but not (at least in the beginning) advertising. Other brands rely on a competitive launch price (e.g., Swatch). It would be difficult and potentially even irrelevant for these brands to calculate the value using the historical cost method since there would be fewer cash outflows than for other brands.

Valuation by historical costs tends to generate higher values for brands that rely more heavily on advertising. However, past expenditures are not *per se* a guarantee of a brand's current value, and this method yields lower values for more recent brands, which is not necessarily true.

Of the cost-based approaches, the historical cost method is easy to understand and robust to implement. It defines the value of a brand as the aggregation of all historical costs incurred to bring the brand

to its present state. This includes development, marketing, advertising and communication costs. Cost-based approaches are used in combination with other approaches. I consider they fail when used alone because there is no direct correlation between the financial investment made and the value added by a brand. Financial investment is an important component in building brand value, provided it is effectively targeted.

## The Market Approach

When valuing a brand, why not start with the value of similar brands in the market? This is how apartments or second-hand cars are valued. When purchasing a flat we look at the price per square metre of similar apartments in similar locations, and adjust upwards or downwards for specific characteristics.

This method is very appealing because it deals with real current data, whereas the income-based approaches deal with estimated future data. But it raises two major issues.

Firstly, there is no market for brands. This method would involve observing comparable brands for which we already have a value. Defining comparable brands is difficult as by definition brands have unique and differentiating features. Especially in luxury, the source of a brand's value lies in its uniqueness, the dream of holding it. Moreover, brands are not sold and bought alone, the transaction usually includes a whole company.

Secondly, in the real estate market the buyer is a price taker, whereas for brands buyers are price makers. "In April 1990, Jean-Louis Sherrer was bought for three times less than the price that M. Chevalier paid for Balmain two months earlier. For M. Chevalier, Balmain was a means of entry into the luxury market. Hermes, which was already present on this market, didn't need to pay this price."[11]

Thirdly, in the model developed by A. Damodaran,[12] brand value is expressed in terms of sales as:

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[11] J-N Kapferer, *The New Strategic Brand Management*, Kogan Page Ltd. 2011, 5th edition.

[12] http://pages.stern.nyu.edu/~adamodar/New_Home_Page/lectures/brand.html.

$$\text{Brand value} = \left[ \left( \frac{P}{S} \right)_B - \left( \frac{P}{S} \right)_N \right] \times \text{Sales}$$

where $(P/S)_B$ is the price to sales ratio for the company with the branded products and $(P/S)_N$ is the price to sales ratio for the company without brands.

Apart from the fact that we are using the company's total sales rather than those of the branded products, this method is particularly unsuited for the luxury industry because luxury brands pride themselves as being unique.

The comparable brands method and the historical cost method can provide interesting cross-checks with income-based methods. However, they should not be used alone to value brands.

## Conclusion

Several commercial agencies such as Interbrand, Millward Brown or Brand Finance use proprietary approaches to calculate and publish rankings of brands every year. They are considered reliable and trustworthy by their users. In spite of this fact, there are discrepancies in the amounts and trends published by these agencies (Table 6.5).

These discrepancies arise from the fact that each agency uses a different method and different assumptions. Every precaution should be taken when performing a valuation. The debate about bringing financial reporting more in line with the reality of long-term corporate value is likely to continue, but if there is greater consistency in brand-valuation approaches then corporate asset values will become more transparent.

**Table 6.5** Comparison of formulary approaches to brand valuation for three luxury brands

| 2015 | Interbrand | Brand finance | Millward brown (BrandZ) |
|---|---|---|---|
| Value of the Hermès brand | $ 10,944 m | $ 6214 m | $ 18,938 m |
| Value of the Cartier brand | $ 8882 m | $ 7319 m | $ 7612 m |

As a matter of fact, a brand's financial valuation should not be conducted with only one method. It should also involve marketing and financial experts and be subject to debate and negotiation. We should even be suspicious if we come up with one unique value stemming from several methods!

As a conclusion, bear in mind the following key principles for brand's financial valuation:

Brand valuation is an opinion.

Brand valuation is a function of profitability (future cash flows and growth rate) and risk (discount rate).

Brand value is contextual; it depends on the objective of the valuation.

Brand financial valuation requires a multidisciplinary team (Michel 2014), and should include qualitative aspects of brand equity such as name awareness, customer loyalty, perceived quality, etc.

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# 7

# Brand as a Legal Asset for Luxury Companies: Brand Power

Caroline André and Arnaud Fournier

In any marketing process, it is essential to use the law to optimize the actions of managers, and it can be a genuine lever for achievement. In such cases the law is not perceived as an obligation and a constraint, but as a catalyst for success (André and Rigaud-Lacresse 2014, p. 10). Thus, M. Sakakibara and M. E. Porter (2001) invite managers to change their perspectives on the law, which can be a driver, a provider of opportunity. Knowledge of the law is thus particularly useful when choosing the sign that will be registered as the trademark, or when thinking strategically about the defence mechanisms to be set up to fight against

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counterfeiting. This aspect will be discussed in more detail in the section "Brand Protection Against Competitors".

Knowledge of the law is also particularly useful when choosing the communication and distribution strategy. Section "Competition Protection Against Brands" will show that luxury brand managers must keep an eye on a growing power law that is beginning to surpass trademark law: the European competition law. Yet, it will be seen that these competition law constraints are pushing managers to finally make the best decisions for their brands: sell products directly and avoid independent distributors.

Knowing both of these laws (trademark law (1) and European competition law (2)) is of particular importance when planning a luxury brand strategy (image, communication and distribution of the branded products) as well as measuring the level of risks of this strategy.

It is in that sense that law is a catalyst for success.

## Brand Protection Against Competitors

### 1. Conditions for Brand Validity

Many different types of sign may be registered as trademarks. They can be divided into sounds (jingles or other sounds), names (invented names, patronymic names, geographical names, letters, figures, etc.), symbols (logos, colours, the shape of the product, etc.) and smells (odours). For the sign to be registered with a trademark organization,[1] it must be possible to transform it into a graphic representation[2] that is "clear, precise, complete, easily accessible, intelligible, durable and objective".[3] In the luxury sector, imagination and creativity have given birth to the following brands,

[1] L'Institut National de la Propriété Intellectuelle (France); United States Patent and Trademark Office (USA); European Union Intellectual Property Office (Europe); World Intellectual Property Organization (International).

[2] The trademark package, which entered into force during the first quarter of 2016, abolished this requirement. Now, to obtain a trademark, it is sufficient that the sign "be represented in the registry in a manner that enables the relevant authorities and the public to identify precisely and clearly the subject that benefits from its owner's protection". This change opens the door to olfactory (smell) and sound trademarks that it has almost never been possible to register before.

[3] CJCE, 12 December 2002, Sieckman decree.

among many others: Mont Blanc; Baccarat; Dior; Yves Saint Laurent; and Armani. All these brands must satisfy the conditions for trademark validity. Here, the law is crucially important for marketing departments. They must choose a sign that is likely to establish an original brand but will not be pronounced invalid by a judge during a trial for counterfeiting. The registration of a trademark indeed only assumes its validity, but it is the responsibility of the judge to decide on this. A trademark is valid first if it is legal (*first condition*). This requirement means that the sign must not be prohibited (by national or international law). In France, for example, it is impossible to use the five Olympic rings or the Olympic motto for commercial purposes.[4] Internationally, it is forbidden to register as trademarks national emblems, official signs of control or the emblems of intergovernmental organizations.[5] In additional, the trademark is legal if it is not contrary to public order or public morals (France) or if it is not a “scandalous” sign (Australia). In other words, the trademark must not refer to the use of narcotics, incite hatred or violence, or comprise an obscene formula or drawing. As an example, the European registration of the trademark of a Russian designer, which included the former Soviet emblem, was refused[6] because this is a symbol of despotism. Luxury brands are rarely concerned by the legal requirements, because the values they convey are often quite contrary to bad taste and vulgarity. One exception to this was the Yves-Saint-Laurent perfume, Opium. Registration of this brand was refused, and the luxury perfumery appealed against the decision. On appeal, the trademark was declared legal, since it had no direct relationship with the use of narcotics.[7] Next, a trademark is valid if it is distinctive (*second condition*). A trademark is distinctive when it distinguishes a product or service without possibility of confusion from products or

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[4] Article L.141–5 of the French Code of Sport law.

[5] Article 6*ter* of the Paris convention dated 20 March 1883, as amended, for the protection of industrial property.

[6] TPICE, 20 September 2011, affair T-232/10. This sign shows the traditional Soviet emblems of the hammer, the sickle and the five-pointed red star above a globe, along with two crowns of wheat covered with ribbons bearing the slogan “Workers of the World, unite!” in the languages of the fifteen former Soviet republics.

[7] The judge decided that “the abundant literature has familiarized the public with the figurative sense of this word, the averting of real difficulties and an escape towards dreams”: CA Paris, 7/05/1979, “opium”, PIBD, 1980, no. 256 III. 87.

services of the same type proposed by competitors. The requirement of distinctiveness results from the function of the brand as a guarantee to the consumer of the origin of the product or the service identified by the brand. To fulfil this requirement, the trademark must be original in some way. However, the originality of a brand sometimes pushes designers to choose a “risky” trademark, as demonstrated by the case of Louboutin. In this case the trademark, consisting of a “red shoe sole”, was deemed invalid. The French judges considered that “neither the shape nor the color of the sole comprised a graphic representation that could be represented visually and (…) the sign (…) lacked any distinctive character”.[8] A trademark is valid if it is not misleading in nature (*third condition*). A sign that is liable to mislead the public, particularly with regard to the nature, quality or geographical origin of the product or service, cannot be adopted as a trademark.[9] In France, for example, the brand Mokalux for a second-best coffee was deemed invalid.[10] Luxury brands are particularly careful with regard to the quality, knowhow and composition involved in their products, and the corresponding communication. The firm La Prairie, for example, registered the trademark “absolute filler caviar luxe” for face care creams based on caviar, and indeed the creams contain caviar. However, the communication is not always faultless. For example, Louis Vuitton advertising was outlawed in the United Kingdom as misleading. The advertising showed women sewing a handbag and making the folds in a wallet. The Advertising Standards Authority (ASA) considered that they might make consumers believe that these products were entirely handmade, whereas Louis Vuitton manufacturing processes also include the use of sewing machines. Louis Vuitton was not able to give the ASA details of the proportion of work carried out using sewing machines.[11] Finally, a trademark is valid if it is available (*fourth condition*). To register a trademark, the sign used must not already be protected for use by a third party. It is therefore a requirement that when the sign is registered, its rights have not been acquired by a competitor in the same sector (brand,

[8] Cass. Com., 30 May 2012, no. 11–20.724.

[9] The deception can also originate in the composition of the product or service or its origin.

[10] The issue here was consumer protection and economic public order.

[11] http://mode.blog.lemonde.fr/2010/05/30/vuitton-condamne-pour-publicite-mensongere/.

store name, trade name, protected designation of origin, etc.).[12] To make a sign unavailable as a trademark, it must be protected in the same commercial sector and geographical area (one or more countries) as that in which the organization wishes to register the trademark. Inversely, it is possible to find identical trademarks for different products: for example, the brand name Mont Blanc is held by different companies, and designates both luxury leather goods and cream desserts. Nevertheless, judges are aware of the economic stakes, and sometimes ban near identical trademarks even for different products. For example, the Lind'or brand of nutritional products was deemed invalid because the Lindor brand of chocolate already existed (Azéma and Galloux 2012). Another example was the Yves Saint-Laurent perfume Champagne which was also deemed invalid. Champagne is a protected origin product, which takes precedence and is strongly protected both nationally and internationally. Firms sometimes face this requirement, particularly if the international development of the brand has not been planned in the medium term.[13] Similarly, luxury brands are the subject of additional protection beyond the principle of specialty.[14]

## 2. Legal Action to Protect Brands

The law proposes different means of protecting trademark. These have different names and the legal regime varies depending on the country. Nevertheless, they have similar features and all allow legal actions against counterfeiting. We have studied French law, insofar as it offers the holders of trademarks three ways to protect themselves against counterfeiting. Firms that intend to protect their brand cannot cumulate legal actions because this is prohibited by law (a single wrong action cannot receive a double sanction, even when resulting from actions based on different

[12] See article L.711–4 of the French Code of Industrial Property Law, which includes: company name, store name, author's rights, rights to a protected drawing or model, personal name, pseudonym or its image, the name, image or reputation of a local authority.

[13] Remember that a French trademark is only protected in France; a European trademark is only protected in the European Union, etc.

[14] See p. XXX.

laws). However, it is possible to combine an action against counterfeiting with one against unfair competition or parasitism, and a real "attack strategy" becomes essential. In view of past experience (Caron 2010; Bonnard 2008), it is not necessarily prudent for a trademark holder to base legal action on counterfeiting. Indeed, in most cases, the firm being sued does not hesitate to ask for the brand to be invalidated, suggesting, for example, that one of the conditions for claiming industrial property is not fulfilled. A penalty for counterfeiting therefore cannot be decided before the validity of the counterfeited trademark has been checked. In practice, the judge quite often deems the trademark invalid. The luxury shoemaker Louboutin learned this by bitter experience.[15] The company would have done better to avoid a legal action for counterfeiting. Its brand would still have been valid, and it would have been able to boost its intangible assets, draw up licensing contracts and so on. It would have been more prudent to have taken action for unfair competition (Article 1382 of the French Civil Code), even if the stealing of economic value is not easy to prove. In practice, luxury brands often combine actions against counterfeiting and unfair competition. However, to win such a case, separate liabilities must be proven, as illustrated by the case of Kenzo's Parfum d'été. The company Via was selling a perfume called Idaho that Kenzo considered to be a counterfeit of its perfume Parfum d'Été. After comparing the packaging used by Via with that registered by Kenzo, the judges considered that Parfum d'Été had been counterfeited by imitation. They decided that the resemblance that they saw between the two products was greater than the differences, and considered that this resemblance generated a risk of confusion in the mind of consumers paying average attention who did not have the two signs (brands) in front of them simultaneously. As for the success of Kenzo's action for unfair competition, it can be explained by the existence of a different offence from that proving counterfeiting. Here, Via's offence consisted in using a fragrance very similar to that of the counterfeited perfume. According to the judges, the sale of products with such similar fragrancies, in packaging that had been declared counterfeit, at a much lower price than that charged by the firms Kenzo and Tamaris, demonstrates the unfair

[15] Cited on page XXX.

competition practiced by Via, which intended to ride on the coat-tails of Kenzo and benefit from its reputation.[16] The European Union (EU) and individual States pay particular attention to brand renown. It is thus protected over and above the principle of specialty.[17] In France, the law gives such protection to "well-known" (notoires) or "renowned" (renommées) brand sor prestigious brands (Bretonnière 2009).[18] A well-known brand is defined as being one that is known to a large proportion of the public.[19] To decide on this, the judge uses different indicators such as the age of the brand and duration of its use, the broad distribution of the product and advertising levels. To be considered as such a brand, it is therefore not sufficient to demonstrate that it is well known, but that it has achieved a certain level of awareness in the general public, who will immediately associate the sign with the mark. The level of recognition of the brand is judged depending on the brand's market share, the intensity, geographical spread and duration of its use, and the size of the investments made by the firm to promote it. The fact that brands are well known is often referred to in legal actions to protect them:[20] for example, Armani[21] and Chanel.[22] As for renowned brands,[23] these are known by a significant proportion of the public concerned by the products or services sold under the brand. Such is the case for the brands:

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[16] Cass. Com., 18/04/2000, no. 97–19631.

[17] Recall that brands are subject to the principle of specialty. That is "the registration of the brand gives its owner the right of property over this brand for the products and services he has designated" (L.713-1 CPI). In other words, the protection of a brand can only succeed if the sign that has been registered is used by an unauthorized third party to designate identical or similar products or services. Thus, it is possible to find the brand Mont Blanc on luxury leather goods and on cream desserts; the brand Pontiac can be found on automobiles and refrigerators.

[18] Article L.713-5 of the French Code of Intellectual Property Law.

[19] Cass. Com., 20/11/2012, no. 12-11.753. The judge expressed his decision as follows: "but given that having rejected the thesis that the public concerned was a prestige clientele, and retained the fact that there was reason to take into account the general public's awareness of the brands involved".

[20] Renowned brands are not necessarily luxury brands: Etam CA Nouméa, 1/08/2013, RG 12/00393; Le Méridien and Méridien, Cass. Com., 21/10/2008, no. 07-14.979; Desperados, Cass. Com., 10/02/2007, no. 05-10.462; Lego, CA Paris, 6/03/1986; Mazda, CA Paris, 19/10/1970.

[21] Cass. Crim., 26/09/2012, no. 11–85.743.

[22] Cass. Com., 24/05/2011, no. 10–18.474.

[23] Suzuki and Aprilia, Cass. Crim., 27/03/2012, no. 10-88.812 International renown; Esso, Cass. Com., 8 April 2009, 06-10.961; The Agatha Scottish-terrier, CA Paris, 5/3/2014, PIBD, 2014, no. 1004, 340.

Givenchy,[24] Vuitton[25] and Must by Cartier.[26] Their reputation is thus not as strong as that of a well-known brand (marques notoires). Whether the brand is well known or renowned will have an impact on the principle of specialty, and thus the chances of success of legal action for counterfeiting. Even if they do not receive absolute protection,[27] signs referring to well-known brands are often protected if it is demonstrated that the applicant attempted to profit from the power of attraction of the well-known brand. This type of behaviour can also weaken the power of attraction of the well-known brand. With regard to renowned brands, the law specifies that the reproduction or imitation of a renowned brand for products dissimilar to those designated in the registration renders the author civilly liable if the reproduction or imitation might damage the owner of the trademark, or if it constitutes unjustified exploitation of the owner. The owner of a renowned brand can thus take legal action to defend the trademark in two cases: when use of the trademark causes them damage; and when the brand is unjustifiably exploited. The risk that the brand will become commonplace thus enables the owner to take action against organizations that use the trademark for different types of product.[28] This type of protection is also granted when the litigious sign is a term close to the trademark that might generate confusion, as the Cartier case illustrates. Cartier is the owner of the brand Must. Noting that the firm Oxypas had registered and was using the brand Pedimust, Cartier decided to take civil action against the firm. The Paris Appeal Court (28 May 2003) nonetheless rejected the litigation. The judges considered that French law, which establishes an exception to the principle of specialty, must be interpreted restrictively. They considered that the law can only sanction the use by a third party of an identical sign to

[24] TGI, Paris, 22 June 2012, RG 2011/06352, Givenchy against Tati Web and textiles representation.

[25] CJUE, 23/03/210, aff. C236/08.

[26] Cass. Com., 12 July 2005, no. 03–17.640.

[27] The well-known brand Pontiac can also be found on automobiles and the brand Pontiac on refrigerators (CA Paris, 8/12/1962)—the well-known brand Mazda on lamps and the brand Mazda on automobiles (CA Paris, 19/10/1970).

[28] This was the case for the use of the Vuitton brand for the publication of musical recordings in a cover bearing a pattern close to that registered by Vuitton as a figurative sign to indicate leather products sold by the firm Louis Vuitton Malletier: Cass. Com., 11/03/2008, no. 06–15.594.

that of the renowned brand, but not the use of a sign that is similar in form or in evocations. The Supreme Court (Cour de cassation)[29] overturned the decision of the appeal court on the basis of European jurisprudence.[30] The latter has established the following principle: "a member state (…) is expected to grant specific protection in case of the later use by a third party of a brand or sign that is identical or similar to the renowned registered trademark. Therefore, the use of a similar or identical sign to the trademark renowned for products or services dissimilar to those designated in the registration exposes its authors to the risk of civil action if it is of a nature to damage the owner of the trademark or if it constitutes unjustified exploitation of the brand." The appeal court was thus mistaken in considering that the use of a sign similar in form or evocations (Pedimust) could not be considered as infringing on the rights of a well-known brand (Must).

## Competition Protection Against Brands

When managing a brand, the potential risks of each new decision must be carefully anticipated. In the luxury industry, trying to assess the degree of risk is particularly problematic as the way a brand is perceived by the public is essential to its success. It is therefore very important to be aware of some of the legal risks that luxury brands will inevitably have to deal with. Currently, the most hazardous of these risks is EU competition law.[31]

This chapter takes a pragmatic, concise (and of course non-exhaustive) look at six issues that can pose a problem when setting up a global *communication* and *distribution strategy* for a luxury brand. On the other hand, knowing these issues could become a competitive advantage for luxury brands.

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[29] Cass. Com., 12/07/2005, no. 03–17.640.

[30] CJCE, 23/10/2003, affaire C-408-01 Adidas Salomon c/ Fitness World trading.

[31] If only because of fines that may be as high as 10 % of consolidated global annual turnover (sales).

## 1. Communication Strategy—The Issue of "Made in" Origin Marking

On 17 March 2010, the Italian parliament adopted the "Reguzzoni-Versace" Act, which makes it mandatory to indicate the country of origin of certain types of products (mainly leather goods and shoes). The "Made in Italy" marking is required on finished products that undergo at least two manufacturing steps in Italy and for which the other manufacturing processes are traceable.

The problem is that the decrees necessary to implement this new law have never been issued by the Italian government, due to the European Commission's informal opposition; and indeed, the Commission did not want the Act to be applicable. This makes Italy's initiative just another wish in a long list of "Made in" laws that certain Member States of the EU (France, Spain and Ireland in particular) dream about passing.

The European Commission has been opposed to this for quite some time[32] and for two main reasons.

*First* of all, it believes that it alone has the power to create a geographical indication of origin,[33] which could be enforced throughout the EU, since as one EU judge put it: "Provision should be made for a Community approach to designations of origin and geographical indications". The European Commission have then a monopoly for creating this.

*Secondly*, and above all, the European Commission believes that if each country were free to create its own type of "Made in" designation of origin this could increase protectionism and hinder trade within the EU countries, which would be in contradiction with the spirit of the Treaty on the Functioning of the European Union (TFEU).

This however has not discouraged the EU countries and they have tried to adopt another strategy, of bypassing the European Commission—and therefore not having any "Made in" protection throughout the EU—and taking action on a strictly national level, with national sanctions only.

The problem with this however is that the Commission believes that if national laws making origin marking mandatory were passed, this would

[32] Already in 1979, with Irish jewels, and in 1896, with French textiles.

[33] For example, see European Court of Justice decision C-478/07—*Budejovicky Budar*.

inevitably encourage national consumers to purchase their national "Made in" products and would thus exclude other imported products of the same type. The effect of this would simply be equivalent to "quantitative restrictions on the free movement of goods between the Member States", which are strictly prohibited under Article 34 of the TFEU.[34] It is therefore in the name of competition law and the free movement of goods that the European Commission is adamantly opposed and sanctions countries that attempt such legislative experiments.[35]

"Made in" indication of origin therefore cannot be mandatory. It can only be provided optionally and for guidance purposes, and is therefore subject to the various abuses that may be expected. Since national customs and fraud-prevention authorities cannot do anything in the absence of mandatory and enforceable rules, a "Made in" indication of origin unfortunately cannot constitute effective protection of the interests of luxury brands.

## 2. Communication and Distribution Strategy—The Issue of the Veblen Effect

Marketers of luxury products are very familiar with the importance of conspicuous consumption and the Veblen (1912) effect, according to which an increase in the price of a luxury product (up to a certain limit) may well increase the demand for this product. This positive effect may turn negative however if a luxury product's price declines and thus reduces demand for the product. A luxury brand obviously needs to avoid this sort of situation and this potential threat to brand image must inevitably be dealt with when selecting a distribution strategy. The Veblen effect therefore has implications for both the image (communication strategy) and the distribution strategy of luxury products. Why?

Because the legal problem here is that if luxury brands want to preserve the high-price image of their products they will probably have to stop

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[34] Article 34 of the TFEU—"Quantitative import restrictions and all measures having equivalent effect shall be prohibited between Member States."

[35] See, for example, Court of Justice decisions C-325/00—*Commission v German;* C-6/02—*Commission v France* and C-255/03—*Commission v Belgium*.

selling them through an exclusive or selective distribution system, or any other distribution channel that they do not own directly.

The legal reason for this is that competition law formally prohibits manufacturers of luxury products from using any means whatsoever to explicitly suggest, guide and above all fix the distributors' resale price to the final consumers. This is known as "resale price maintenance" (RPM). However, an independent distributor may sometimes want to sell "at any price", and may therefore lower the price displayed to the consumer and consequently lower demand for the product, as the Veblen effect reverses.

Many luxury brands may therefore be tempted to motivate, recommend or compel (either directly or indirectly) their distributors not to lower the displayed retail price of their branded products beyond a certain point (usually the "recommended" price). This is absolutely contrary to competition law. Although management and marketing staff may simply consider this to be sound business practice, companies are regularly sanctioned for such behaviour.[36]

A luxury brand must under no circumstances intervene in a distributor's decision to set a certain final price to final consumers. It therefore cannot prohibit discounts or rebates, nor even compel an independent distributor to refrain from granting a discount on the products it sells.

Although legal practitioners can easily understand this, they may still be somewhat sceptical, as the European Commission itself accepts the economic theory that there are products for which "an increase in the price (…) increases the demand from consumers",[37] yet clearly fails to take this effect into account when it comes to sanctioning luxury brands.

In some countries, competition authorities have even removed the reference to the Veblen effect from their legal guidelines that govern the authorization and prohibition of concentrations between enterprises, even though the legal concepts involved are extremely similar. The fact that these authorities were discreet in removing this reference when they published their updated guidelines clearly shows their concern that this issue could come into conflict with sanctions against anti-competitive practices.

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[36] For example, over the past few years sanctions have been taken in France (perfumes), Poland (luxury watches), Italy and Germany (high-end cosmetics).

[37] *Commission's Best Practices for the Submission of Economic Evidence* (2011).

Moreover, on their side, US authorities have made no mistake about this. To maintain a consistent position, the judges of the US Supreme Court decided, in 2007, to no longer systematically sanction manufacturers (luxury brands) for fixing the prices that their distributors charge to final consumers. And yet these sanctions were supported by over 100 years of precedent. Each case is now examined in detail and if the manufacturer succeeds in proving that there are objective reasons that justify the fixing of a price (such as, e.g., avoiding a decrease in demand for a given product—Veblen effect) it may hope to avoid a sanction and penalty.[38] Double standards?

Consequently, to avoid sanctions against fixing the resale prices of independent distributors, one legal strategy that has been adopted in Europe and much of the world, is to abandon independent distributors and exclusively sell products directly (e.g., through flagship stores, full-ownership stores, full-ownership corners and similar outlets). This immunizes luxury brands against accusations of anti-competitive "resale price maintenance" practices.

## 3. Communication and Distribution Strategy—The Issue of Exclusive and Selective Distribution of Luxury Products

In the previous example, we saw that a communication strategy (i.e., displaying a price for the final consumer) could directly impact the strategic choice of a distribution channel for luxury products. Here is another example where distribution and brand image go hand-in-hand and may come into conflict with the increasing body of competition law regulations.

Although luxury brands cannot do without independent distributors—since they need a large number of sale outlets to sell their products and lack the capital necessary to create their own—they have the choice between an exclusive, a selective or possibly a franchise distribution system.

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[38] *Dr. Miles Med. Co. v John D. Park & Sons Co.*, 220 U.S. 373 (1911), overruled by *Leegin Creative Leather Prods. v PSKS Inc.*, 551 U.S. 877 (2007).

According to economic and legal theory, all three of these distribution systems may be considered to restrict competition. It will therefore be necessary to prove that the nature of the products made by the luxury brand companies justifies such distribution, especially in the case of exclusive and selective distribution, which will be more specifically our concern here.

Competition law allows certain types of luxury products to be sold *via* a distribution system that restricts competition if, and only if, this is justified by the type of product sold. For example, an exclusive distribution system may be suitable for cars and watches, while a selective distribution system may be justified for perfumes, cosmetics and hi-fi equipment.

Remember that selective or exclusive distribution is not necessarily acceptable for all luxury products, since this results in a "vertical restriction of competition", which competition authorities closely monitor.[39]

The problem that luxury brands may therefore encounter is that they might not be able to select *the* specific distribution system they want, since the possibility of setting up either an exclusive or a selective system will depend largely on their product and the independent distributor.[40] Meaning that if they want to choose a particular distribution scheme (e.g., exclusive or selective) they can; but this will perhaps not be a legal safe harbour for them.

## Regarding Exclusive Distribution

With this type of system, the manufacturer of a luxury product agrees to sell its product to only one distributor for resale within a specified territory. This means that the distributor is often restricted from actively selling in other territories, since they are also normally subject to an exclusive distribution right. Such a system can hinder competition, compartmentalize markets and thus facilitate price discrimination. Although

[39] See, for example, the European Commission's guidelines on "vertical restraints"—2010/C130.01—OJEU of 19 May 2010.

[40] This question is not trivial, since some companies rightly believe that they cannot use an exclusive distribution system and must "make do" with a selective distribution system, and therefore take the risk of "taking the brand out of the luxury universe" (Kapferer and Bastien 2012. p. 244).

this may certainly enable a luxury brand to achieve its marketing objectives more easily, according to certain economic concepts on which the rules of competition law are founded, it will be to the detriment of the final customer.

This type of distribution may be acceptable if the product sold justifies a large investment on the part of the distributor; for example, in qualified personnel and point-of-sale advertising. But the manufacturer's and the distributors' share of the relevant market generally cannot then exceed 30 %. Furthermore, no-compete clauses may not exceed five years and many other specific clauses are also prohibited, etc.

Therefore, if a luxury brand fails to strictly observe the rules of competition law when setting up its exclusive distribution system, it and/or its distributor may be sanctioned and all of their contracts may be declared void![41] In such an event, a distributor may seek redress from the luxury goods manufacturer, if it feels this is in its interest.

## Regarding Selective Distribution

In a selective distribution system, there is no limit to the number of resellers in a given territory. However, there is a limit to the number of distributors capable of demonstrating that they have the necessary competencies to sell the luxury product.

In a selective distribution system, a distributor who is recognized as being competent to sell a specific branded luxury product, must be able to procure this product (it will be then automatically selected as a distributor). Unlike the "exclusive" restriction, the "selective" restriction is therefore no longer really at the discretion of the luxury product manufacturer.

Under competition law, for a selective distribution system to be valid, the product sold must justify the use of such a system and the luxury brand owner must draw up a list of objective *criteria* that will enable the luxury product to be sold under the most appropriate conditions.

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[41] Article 101.2 TFEU: "Any agreements or decisions prohibited pursuant to this article shall be automatically void".

For example, for high-end cosmetic products a distributor will often be required to have one qualified cosmetician or beautician at the sales outlet at all times. Another requirement may be a luxury or prestigious brand environment, a sales outlet that is consistent with the level of luxury required (in terms of decoration, storage premises), etc.

Once these *criteria* are established and are made available upon request, an independent distributor that meets the aforementioned criteria must be able to procure the luxury product without obstruction from the supplier, brand owner or manufacturer of the luxury product. It is then mandatory!

One last important remark: the criteria that apply to a physical or "bricks and mortar" sales outlet are transposed to be applied to its sales over the internet.

Moreover, competition law does limit competition to some extent by allowing only distributors that already have a physical sales outlet to sell via a website, which eliminates pure players and free riders.[42]

If luxury brands fail to ensure that their selective distribution system complies with all competition law requirements, it may be deemed to be illegal, in which case mass-market distributors, for example, or distributors that otherwise would not have been selected could legally compel luxury brands to supply them with the brand's luxury products.

The fact that both exclusive and selective distribution systems are still risky, and may compromise luxury status, most likely explains why the major luxury brands have decided (once again) to avoid them and sell their luxury products directly.

## 4. Distribution Strategy—The Issue of Parallel Imports of Luxury Brands

It is common knowledge that living standards and income per capita vary considerably throughout the EU. That means that in some countries

[42] This is why, for example, luxury brands that want to sell their products directly on a dedicated website (which they directly control) are well inspired to open a physical "bricks and mortar" store. In doing so, they not only require of themselves what they require of their distributors, but are also able to justify, if necessary, the criteria they require.

consumers can pay more for a product than others consumers in other countries for the same product. Consequently, the final price to consumers of a given luxury product may often vary throughout the EU.

This situation has given birth to a specific category of wholesalers and distributors known as "parallel importers", whose livelihood depends on importing luxury products from a country (B) where they are cheaper than in the importer's home country (A) and selling them to consumers in country A at a price that is generally lower than the "normal" sales price in this country, despite the extra shipping costs. We may therefore find distributors in country A (whether selected or not) selling luxury products imported from country B.

If a brand's marketing strategy is to use the same packaging in all EU countries (to reduce costs) the final customer, and even the distributor, may not always know whether or not a product was imported from another country. This makes it easier to sell a product for less than its normal sales price. This is the reason why sometimes brands choose to manage differently the packaging across the EU, for example, despite the fact this would increase costs.

This weakens the position of luxury brands, since they will not be able to oppose resale at a lower price (as we have already seen) nor even prevent an unselected distributor from selling the luxury product. The guilty party? European competition law.

The reason for this is that, under European law, once a luxury product has been sold in the EU with the manufacturer's consent (i.e., either directly by the manufacturer or through a selected distributor in country B), the manufacturer can no longer oppose the movement of this product within the EU, and consequently cannot oppose the shipment of the product from B to A, for example. The manufacturer therefore cannot attempt to prevent, hinder or prohibit this movement from B to A, even, for example, on the grounds of trademark law.

This European legal rule, which is known as the "exhaustion of rights", has essentially the following consequences:

- The luxury product manufacturer and brand owner cannot (by contract) require its selected distributors to restrict the movement of luxury products within the EU and thereby "compartmentalize"

markets. Such a clause, and even the entire contract, could be declared void.
- The luxury product manufacturer and brand owner cannot (using any means whatsoever) prevent an unselected distributor that has succeeded in procuring a luxury product legally from selling this product.

This may seem very surprising to luxury brand marketers, since we have seen that the applicable law agrees that it may be necessary, in respect of certain types of products, to ensure that pure players do not become free riders, and above all that certain products may only be considered to be sold under the appropriate conditions if distributors are selected objectively on the basis of their competencies. However, given the exhaustion of rights rules, which enable unknown distributors to sell such products, it may be difficult to defend the quality of luxury products and brand image.

EU law and competition law are however aware of and have addressed this problem. Although the courts feel that nothing can be done about the free movement of products (luxury products must therefore be allowed to circulate unimpeded throughout the EU), nor about the price at which products are sold (nothing can be done to prevent prices from being lowered), it is however possible to take action against an unknown distributor (unselected).

European courts assess that a luxury brand owner cannot oppose the sale of a luxury product by such distributors, but it is still possible to use trademark law (counterfeiting argument) or tort law to prevent such sales, provided that:

- the unselected distributor's sale of the product may damage the brand's image or reputation;
- the unselected distributor modifies the packaging;
- the unselected distributor modifies the product when handling it; or
- the unselected distributor relabels the product or packaging.

This was enough to give luxury brands the idea of attaching an overt or covert tracking device[43] directly to the luxury product or its packaging. In order to remove this tracking device, the parallel importer (or unselected distributor) must therefore modify the packaging or the product itself, which thus directly enables counterfeiting actions to be taken against the parallel importer.

One device that is very popular with luxury brands is the RFID chip, which when attached to the product or its packaging not only enables the product to be tracked (and thereby reveals who "diverted" it to the parallel importer) but also enables appropriate measures to be taken to limit the number of luxury products that find their way to parallel importers before they can be sold by unselected distributors.

It must of course be kept in mind that parallel importers not only obtain their goods from selected distributors of other countries, but also discreetly from luxury product manufacturers themselves, or rather their subsidiaries, when they need to boost their sales. This is why a luxury brand owner must also keep a close eye on its own group and subsidiaries. The RFID chip enables this internal oversight.

## 5. Distribution Strategy—The Issue of New Technologies for Luxury Brands—The RFID Chip

As explained in the previous section, there is nothing currently that prevents luxury brands from using RFID chips (for example) to track their products in an effort to restrict parallel imports.

There is a risk however that these RFID chips can also be programmed to include the "recommended" resale price when an independent distributor receives the product. This is currently still possible.

However, if an independent distributor uses its chip reader to enter the public resale price directly into the distributor's IT system (a central cash register for example), this could easily be construed, under competition law, to be an attempt by the luxury product manufacturer to fix the

[43] Overt technologies are, for example, holograms, filigrees, VOE, OVD and individual numberings, while covert technologies include nano or micro impressions, RFID and similar technologies.

price to the final customer, since the distributor will not technically have the freedom to select (or easily select) the final resale price. This could be legally upgraded as resale price maintenance. It may even be considered that the manufacturer could be automatically informed of a price change by the distributor, which under competition law could easily be construed to be evidence that a computerized and automatic system for controlling prices, or at least monitoring them, has been put into place.

This, in itself, could well be enough to sanction the product manufacturer *and* the distributor under competition law (Article 101.1 of the TFEU) once again.

## 6. Distribution Strategy—The Issue of New Technologies for Luxury Brands—Online Geographic Blocking

Since brands have not been able to prevent distributors that have physical stores from selling over the internet,[44] to restrict sales between countries they might be tempted to include geo-blocking clauses in their contracts with independent distributors.

Such a clause in a distribution contract would be, for example, to require the distributor to block or delay a sale to a customer who is outside of the territory specified by the luxury product manufacturer or brand owner. The distributor will therefore refuse to deliver it to a foreign country or refuse a foreign means of payment. A more direct and unequivocal solution would be to automatically redirect the customer to the appropriate website in the customer's home country or to block access to the site the customer seeks to access. This is generally done using the customer's IP (internet protocol) address.

A luxury brand is, of course, allowed to impose such restrictions on itself and take such actions unilaterally when it sells its products directly, provided that it is not in a dominant position, pursuant to Article 102 of the TFEU.

Nevertheless, such practices may very easily be sanctioned under competition law if they are seen to have been arranged contractually

[44] See decision C-439/09-*Pierre Fabre dermo-cosmetics* or points 52–56 of the *European Commission's Guidelines on Vertical Restrictions*: 2010/C130/01.

with independent distributors by the luxury brand (or simply agreed informally—means playing the game), since such practices hinder and prevent the movement of goods within the EU.

Distributors who accept these contractual terms or implicitly agree to play the game will be construed (with the manufacturer) under competition law to be an “anti-competitive agreement”. In such a case, the sanction will be the same as for anti-competitive behaviour via a vertical agreement prohibited under Article 101.1 of the TFEU. Once again, luxury product manufacturers and independent distributors may not only be sanctioned but may also see their contracts automatically declared void if such a clause is deemed to be truly detrimental,[45] which we believe has been the case for several years now.

## Conclusion

In conclusion, it is easy to see that one strategic solution that will enable luxury product manufacturers and luxury brands to avoid the strict requirements of European and competition law is to bypass independent distributors entirely and distribute their luxury products directly through their own outlets.

This is the strategy that most retail and marketing experts seem to favour. It is also the retailing strategy that most legal practitioners specialized in European competition law seem to prefer. Although this does come at a price, the cost will most likely be recovered over the medium term.

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# 8

# Knowhow, Skills and Competencies as Knowledge Assets for Luxury Companies

Fabien Seraidarian and Ruxanda Kmiec

The luxury sector occupies a key place in textile, clothing, leather and footwear production, and represents values and identities, as well as creativity (European design heritage European Sector Skills Council 2014).

Although the luxury sector continues to demonstrate significant potential for development and employment (e.g., in 2015, 165,000 jobs at least in France were linked directly or indirectly to the luxury industry according to the French Government 2016 on its website page, dedicated to fashion and luxury: La mode et le luxe: secteurs d'excellence française; La mode et le luxe: 7 chiffres pour être #FiersDeLaFrance)), it also faces constraints. For example, shortages

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of manufacturing human resources, changing employment models and market instability all influence strategies and management processes in luxury companies. The expansion of management education, with courses specializing in the luxury sector alongside general management education programmes ensure a good supply of human resources and a broad range of professional profiles for middle and senior management positions. Nevertheless, the need for manufacturing workers is not satisfied. Consequently, we face a paradox: higher education is providing increasing numbers of graduates for jobs in the luxury sector, while manufacturing workers are in short supply. Manufacturing work has lost its attraction for the young, and in some cases training is unavailable. This lack is caused by endogenous factors (e.g., lack of attractiveness of some occupations) and exogenous factors (e.g., technological evolution; globalization; the rapid, constant evolution of jobs; new competencies and occupations; the continuous need to update and maintain skills; digital revolution). It destabilizes the value chain and affects the resources and capabilities that organizations in the luxury sector require if they are to perform and develop sustainably.

Since the luxury cluster "mission" is to support creativity and maintain skills and knowledge (European Sector Skills Council 2014), it must adjust its strategies to promote all assets: skills, values, knowledge and traditions across domestic and export markets. This is why we consider an approach that integrates resources (their reality, their transformation and their new challenges) and external factors, and is connected to practice is necessary to perpetuate and protect the value chain.

This chapter stresses the resource-based view which emphasizes resources and competencies to create a sustainable competitive advantage in the luxury industry and implement differentiated business development strategies. Beyond the consideration of concepts, the value chain provides a framework to describe the positioning and strategies of competitors within a luxury sector and operational organization at firm level. This perspective accounts for the role and impact of knowhow in developing sustainable competitive advantage in the luxury industry. This chapter also describes configurations in the luxury industry considering position on the value chain and focus on emerging jobs and employability in luxury markets.

## Understanding Sustainable Competitive Advantage in the Luxury Sector: The Resource-Based View Approach

Strategy is a large field with a rich theoretical and empirical base to account for corporate strategic paths and to provide concepts and notions to build organizational dynamics and guide development and value creation. In other words, “it’s a field where everything matters: choices matter, the leader matters, the culture matters, the values matter, random events matter, and so on; strategy is inherently an integrative subject that has to allow for complexity” (Argyres and McGahan 2002, p. 52).

Strategy covers competitive advantage, and increasingly the literature is tackling compressions of distance and time that intensify competition and focusing managerial attention on both internal and external factors (Thomas et al. 1999). To outperform rivals, firms must deliver greater value to customers or create comparable value at a lower cost (Porter 1996). Companies must make choices in areas such as products, services, goals and industry positioning. In practical terms, strategic management is about “the direction of organizations” and is about competition and firm success and failure (Rumelt et al. 1994, p. 9). Organization performance results from a number of factors: factors external to the company, such as the environment (Porter 1996) and internal factors such as the company’s internal assets and management practices (Barney 2002). Focusing on factors outside the firm is called the *industry view,* while looking at factors within the firm is called the *resource-based view*. In the luxury industry both approaches are necessary to design successful strategies: the environment gives evidence of new trends, and product development is at the core of the luxury sector, extending the offer for discerning clients.

The industry view examines the marketplace to determine areas in which firms can compete (Andrews 1980). Porter introduced the industry strengths, weaknesses, opportunities, and threats model, along with the five structural forces that can erode a firm’s long-term average profitability (Porter 1991). The five forces are threats

of new entrants; supplier bargaining power; rivalry among existing competitors; client bargaining power; and threats of substitute products or services (Collis and Montgomery 1995; Porter 1991). The industry view remains a good ex-post description of market conditions and allows firms to identify some of the conditions for normal rent returns, but does not provide information on above-normal profits (Chakraborty 1997). The industry view downplays resource heterogeneity and immobility, which are two key tenets for examining competitive advantage in terms of a firm's internal assets (Amit and Schoemaker 1993; Barney 1991). In contrast, the resource-based view underscores the need for a balanced approach to competitive advantage that emphasizes the firm's strengths and weaknesses (Barney and Zajac 1994). In the resource-based view, companies focus on their asset mix (organizational, physical, financial, human or social assets) and determine which to strengthen and which to disinvest in.

A crucial question for strategist is "why do firms differ and succeed?" In contrast to the industry view that emphasizes the environment, the resource-based view explains firm existence based on internal assets that are scarce, difficult to trade, imitate or appropriate, and which give a firm its competitive advantage (Amit and Schoemaker 1993; Madhok 2002; Porter 1991). The resource-based view makes explicit the value attached to the creation, maintenance and renewal of a competitive advantage through a firm's unique resources, their features and how they change over time (Foss 1997; Schulze 1994). According to Barney, a strategic asset is valuable, rare, inimitable, and has an organizational focus. This is known as the VRIO framework (Barney 2001).

The Barney approach outlines four attributes for developing sustainable competitive advantage. In his original framework, resources must be valuable, rare, inimitable, and non-substitutable (VRIN) (Barney 1991). In a later model, he replaced the term "non-substitutable" with "organizational focus," which referred to managerial support (Chakraborty 1997). A firm's strategic assets may not always be visible; examples of strategic assets include quality, reputation, managerial skills, brand recognition, patents, culture, technological capability, customer focus and superior

managerial skills (Barney and Zajac 1994; Castanias and Helfat 1991; Chakraborty 1997; Hawawini et al. 2003; Kogut and Zander 1993).

The luxury industry illustrates well the significance of the resource-based view. For Rindova and Fombrun (1999: 694):

> Resource-based theory (Penrose 1959; Barney 1991) attributes advantage in an industry to a firm's control over bundles of unique material, human, organizational and locational resources and skills that enable unique value-creating strategies (Barney 1991). Heterogeneous resources create distinct strategic options for a firm that, over time, enable its managers to exploit different levels of economic rent (Peteraf 1993). A firm's resources are said to be a source of competitive advantage to the degree that they are scarce, specialized, appropriable (Amit & Schoemaker 1993), valuable, rare, difficult to imitate or substitute. (Barney 1991)

Barney (1991) notes that two assumptions are elemental to the resource-based-view: (1) resources are distributed unequally between firms, and (2) these productive resources cannot be transferred from firm to firm without cost (i.e., resources are "sticky"). These assumptions are the axioms of the resource-based view. Barney (1991) bases two fundamental arguments on them. First, resources that are both rare (e.g., not widely held) and valuable (e.g., contribute to firm efficiency or effectiveness) can produce competitive advantage. Second, when such resources are also simultaneously not imitable (e.g., they cannot easily be replicated by competitors), not substitutable (e.g., other resources cannot fulfil the same function) and not transferable (e.g., they cannot be purchased in resource markets; Dierickx and Cool 1989), they may produce a long-lived (sustainable) competitive advantage.

Examples of resources in the luxury industry are: brand names, in-house knowhow, technology (in the jewellery sector, for instance), skilled personnel (experienced craftsmen on primary activities), trade contracts (for distribution or with large luxury companies), machinery and equipment, efficient procedures and capital, which has grown in importance as luxury has become capital intensive.

Tacit knowledge is difficult to measure and manipulate; it is often described as knowhow in the luxury industry. Some have argued that tacit knowledge—understanding gained from experience but that cannot be expressed to another person and is unknown to oneself—is a source of competitive advantage. This may be descriptively correct, but it is likely to be quite difficult for practitioners to effectively manipulate that which is inherently unknowable.

Considering the challenges of the luxury industry, the resource-based view provides an appropriate framework for maintaining and developing a sustainable competitive advantage. At this stage, aside from the specific features of each sector and player, the luxury industry as a whole has a number of issues with which it must contend.

1. Strategically, three patterns contribute to the reconfiguration of value chains, implying that firms must pay attention to resources and competencies:
    - Specialization in certain links in the chain to promote advanced expertise, value resources and competencies, and ultimately to strengthen the firm's positioning.
    - Growth of small and medium-sized enterprises (SMEs) in related links, to achieve critical mass and ensure a favourable balance of power in an international environment. In other words, this development along the value chain (integration of different upstream or downstream activities) leads to the creation of significant new capabilities and reinforces competitive advantage.
    - Strategy of integrating the beginning of the value chain, for secure access to expertise and resources and to be able to meet demand and solve manufacturing issues: workload preserving craftsmanship as well as clusterization (creation of an ecosystem, as in the Jewellery sector in France).
2. In operational terms, the dynamics of demand and the need to preserve expertise or knowhow and capabilities, in the language of the resource-based view, are overturning historical models. Actors need to develop new, attractive organizational structures that will allow them

to reconnect their resources and skills. This expanded framework requires a new set of capabilities to succeed in cooperation, partnerships, territorial footholds, and so on.
3. Lastly, the ecosystem has a decisive role to play in promoting expertise, via professional organizations. Major changes in the industry are opening up new opportunities that all players—both professional and institutional—must seize by developing more collaborative approaches, reconsidering their representational roles and promoting handicraft.

To fully understand the critical nature of knowhow, three criteria can be used to evaluate the different sectors under study:

- Existing training and the development of skill sets (external institutions to provide education), to understand the quality and the very existence of existing training and apprenticeship programmes.
- The perpetuation of expertise within the company (how to prevent loss of expertise due to retirement for instance), to evaluate the ability to maintain expertise within workshops, create on-the-job versatility and transmit that expertise.
- The perpetuation of expertise in France or in the country of origin (considering the roots of the brand and the historical expertise), to show the impact of change on the value chain (replacement of expertise, subcontracting, etc.).

## In Practice: Value Chain, Knowhow, Jobs and Employability

In practice, competency could be described as a combination of three dimensions: knowledge, expertise/knowhow and behaviour/soft skills. In the luxury sector, competencies are imprinted by brand identity and history and are transmitted across generations. This is true for knowhow in Champagne houses, where brand identity, specific skills, traditions, innovation and territory inheritance go together.

> Knowhow is at the heart of the Taittinger value system, it guarantees the quality and uniqueness of our cuvées. These are the fruit of a multitude of operations originating in tradition or up-to-date experience. At each stage of production, our obsession for the respect of our identity pushes us to find precise, exclusive methods. It incites us to innovate. To cultivate our 288 hectares of vines, the vineyard manager, who has worked for the house for 30 years, adjusts our spraying and varieties to the needs of each plot, which enables us to maximize their aromatic expression. Similarly, our wines would not be the same without the intelligence and memory of our head cellar master. Blending is an art, based on recognition of terroirs, of the effects of time. Our classic cuvée, the brut réserve, is made up of 35 different vintages from three different years. How can science enable you to succeed in the perilous exercise of obtaining the same taste from year to year? Without a doubt, it can't… Only the know-how of man can. The length of careers in our house bears witness to the importance of this heritage. Thus, Champagne Taittinger has built up its own territory, which is best guaranteed by transmission.
>
> VitalieTaittinger, Champagne Taittinger

In the luxury industry, knowhow comprises a series of practices that are the fruit of lengthy training in a workshop, supervised by a person or a group. It may be tacit or recognized by a qualification. It involves different types of resources: people (human resources) who are capable of using equipment (material resources) and executing procedures (immaterial resources) (Fig. 8.1).

A wide range of knowhow for the value chain originates in artistic professions. An artistic profession combines three criteria: (1) complex knowhow is used to transform materials; (2) unique or small numbers of artistic products are manufactured; (3) professionals or craftsmen master the whole manufacturing process, and thus have an overall view

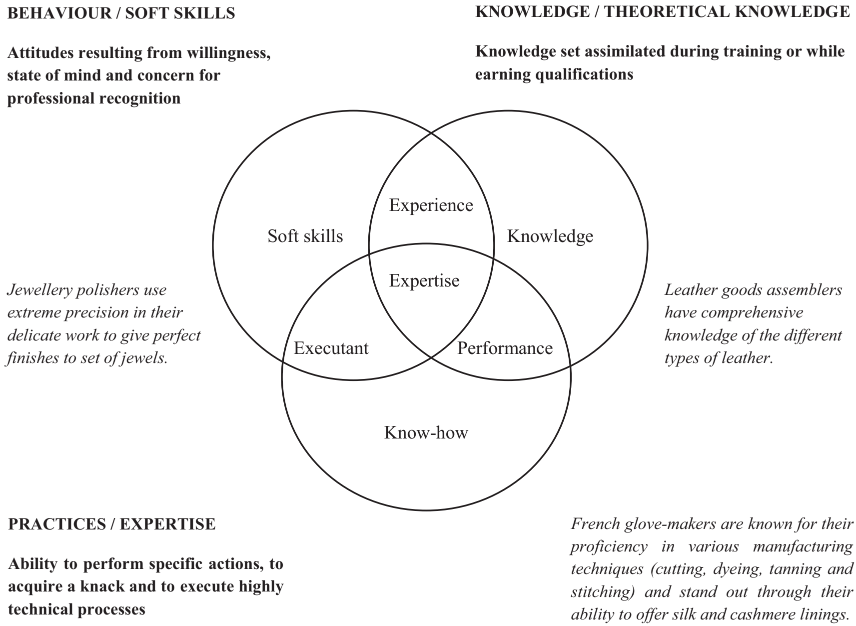



**Fig. 8.1** Dimensions describing a competency

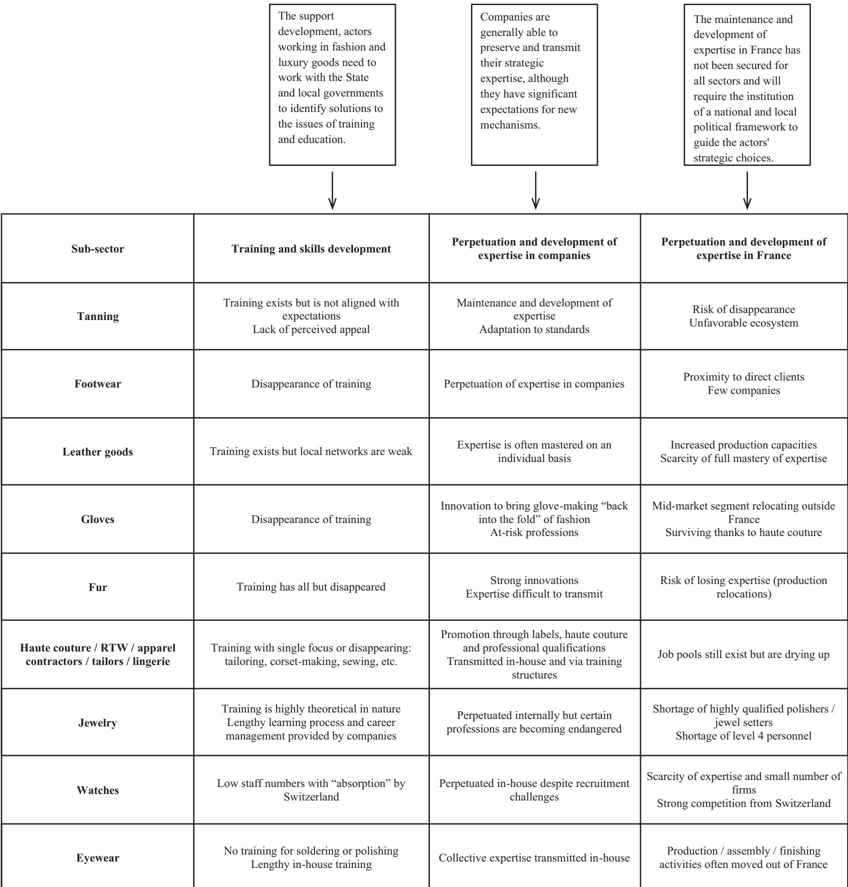
of it (The French National Institute of Arts Occupation/INMA 2016). Consequently, knowhow is born out of experience and socialization within the professional luxury environment. In other words, developing knowhow is a dynamic process. Although it is the legacy of longstanding traditions, knowhow evolves and can even be transformed, through creativity, innovation and the use of new technologies. The value attached to this knowhow depends on the company's ability to develop those resources in response to changing demand, and to establish their legitimacy and positioning.

Furthermore, the study conducted by Mazars was based on the resource-based view: it uses a management framework to explain the impact of strategic decisions, organizational change and the quality of the environment on expertise. It assessed the perpetuation and development of knowhow and capabilities in each sector studied, using three sets of criteria:

- *Training and skills development* (existence of apprenticeships, expertise sharing courses, recruitment, etc.). Knowhow cannot be reduced to qualifications, although our analysis shows that the shortage of well-reputed establishments to attract and train the next generations of craftsmen and entrepreneurs has significantly jeopardized the sustainability of the luxury goods industry, in view of the years of learning required to master an art. Luxury goods firms understand this and are developing their own in-house training centres.
- *The ability to promote expertise within the company* (workshop organization, labels, etc.). Knowhow and capabilities create tremendous value when they are strategic for the company: this is what differentiates fashion from luxury goods. But beyond that, the promotion of expertise is dependent on the capacity to organize production. Of the models studied, the most successful actors are endowed with expertise but are also capable of developing versatility and cooperation in their workshops, to become a key player and meet their direct clients' demands.
- *The presence of national knowhow* (scarcity and specific features of expertise along the value chain, etc.). The preservation of expertise relies on a dynamic ecosystem. Local roots boost territorial appeal and enable encounters with craftsmen that could be conducive to hybridization and the development of new expertise. Federations and professional organizations have to play a significant role if possible to evolve and change their positions, especially embracing the dynamics of capabilities: increasingly working alongside players in the industry, they play a decisive role in supporting internationalization, introducing new technical and intermediation skills, and sharing expertise.

The availability of capabilities at each level of the value chain is impacted by factors such as: multiple specializations (e.g., fashion, leather, jewellery, shoes, watches, fragrances, cosmetic, designer furniture, cars, private jets, yachts); constant preoccupation with increasing service quality (e.g., the need to provide hospitality and gastronomy areas); the inevitable evolution of trends and consumer behaviour in the luxury sector (e.g., social media, multichannel experience for consumers); or new occupations originating in technological and digital innovations (Table 8.1).

**Table 8.1** Main types of knowhow in each luxury sector



The support development, actors working in fashion and luxury goods need to work with the State and local governments to identify solutions to the issues of training and education.

Companies are generally able to preserve and transmit their strategic expertise, although they have significant expectations for new mechanisms.

The maintenance and development of expertise in France has not been secured for all sectors and will require the institution of a national and local political framework to guide the actors' strategic choices.

| Sub-sector | Training and skills development | Perpetuation and development of expertise in companies | Perpetuation and development of expertise in France |
|---|---|---|---|
| Tanning | Training exists but is not aligned with expectations<br>Lack of perceived appeal | Maintenance and development of expertise<br>Adaptation to standards | Risk of disappearance<br>Unfavorable ecosystem |
| Footwear | Disappearance of training | Perpetuation of expertise in companies | Proximity to direct clients<br>Few companies |
| Leather goods | Training exists but local networks are weak | Expertise is often mastered on an individual basis | Increased production capacities<br>Scarcity of full mastery of expertise |
| Gloves | Disappearance of training | Innovation to bring glove-making “back into the fold” of fashion<br>At-risk professions | Mid-market segment relocating outside France<br>Surviving thanks to haute couture |
| Fur | Training has all but disappeared | Strong innovations<br>Expertise difficult to transmit | Risk of losing expertise (production relocations) |
| Haute couture / RTW / apparel contractors / tailors / lingerie | Training with single focus or disappearing: tailoring, corset-making, sewing, etc. | Promotion through labels, haute couture and professional qualifications<br>Transmitted in-house and via training structures | Job pools still exist but are drying up |
| Jewelry | Training is highly theoretical in nature<br>Lengthy learning process and career management provided by companies | Perpetuated internally but certain professions are becoming endangered | Shortage of highly qualified polishers / jewel setters<br>Shortage of level 4 personnel |
| Watches | Low staff numbers with “absorption” by Switzerland | Perpetuated in-house despite recruitment challenges | Scarcity of expertise and small number of firms<br>Strong competition from Switzerland |
| Eyewear | No training for soldering or polishing<br>Lengthy in-house training | Collective expertise transmitted in-house | Production / assembly / finishing activities often moved out of France |

Table 8.1 reveals the extreme importance of training issues: training and qualifications drive knowledge and are a prerequisite for the development of knowhow whose transmission entails a lengthy learning process. Aside from the difficulty of becoming proficient in the individual actions that prove the expertise, the shortage of well-reputed training courses limits the ability to attract talent and also weakens the value chains.

Beyond knowhow and level of expertise, the key challenge regarding capabilities is to assess how far a luxury company is able to value these

distinctive competencies often referred to as capabilities. The value chain tool can combine the traditional industry view with the resource-based lens. The example of the jewellery sector demonstrates the positioning of competitors all along the value chain. Key knowhow and operational settings are identified and featured in relation to the strategies implemented by firms in the sector and for each activity of the value chain. This gives an in-depth representation of firm-level value chain configurations according to sector specificities, key issues, activity, size of company, etc. The illustrations in Figs. 8.2 and 8.3 demonstrate and account for the role and impact of knowhow in the business development of luxury firms.

Luxury companies often find it difficult to recruit competent staff with the specific skills required for their activity. To limit the risk of a breakdown in the production process, companies adapt their organiza-

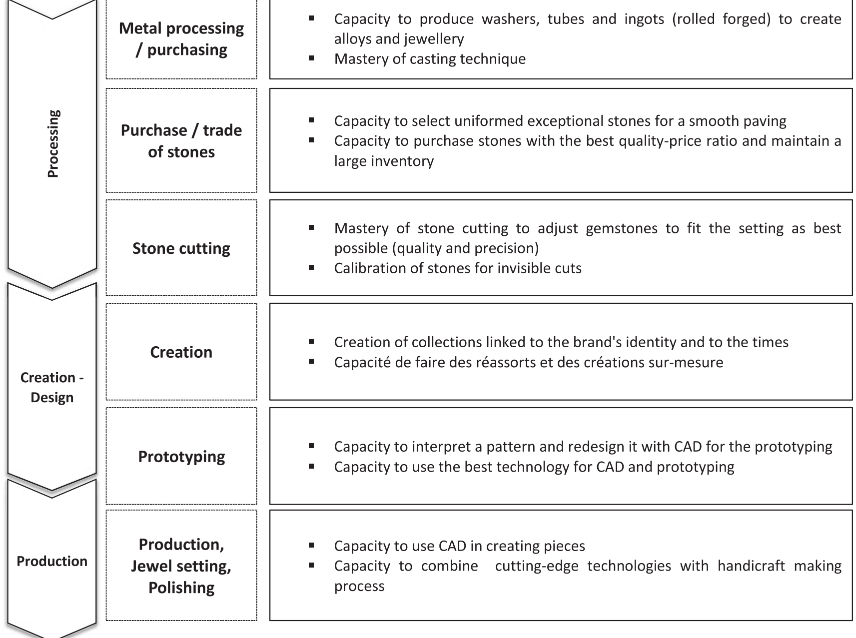



**Fig. 8.2** Jewellery value chain: industrial and resource-based views

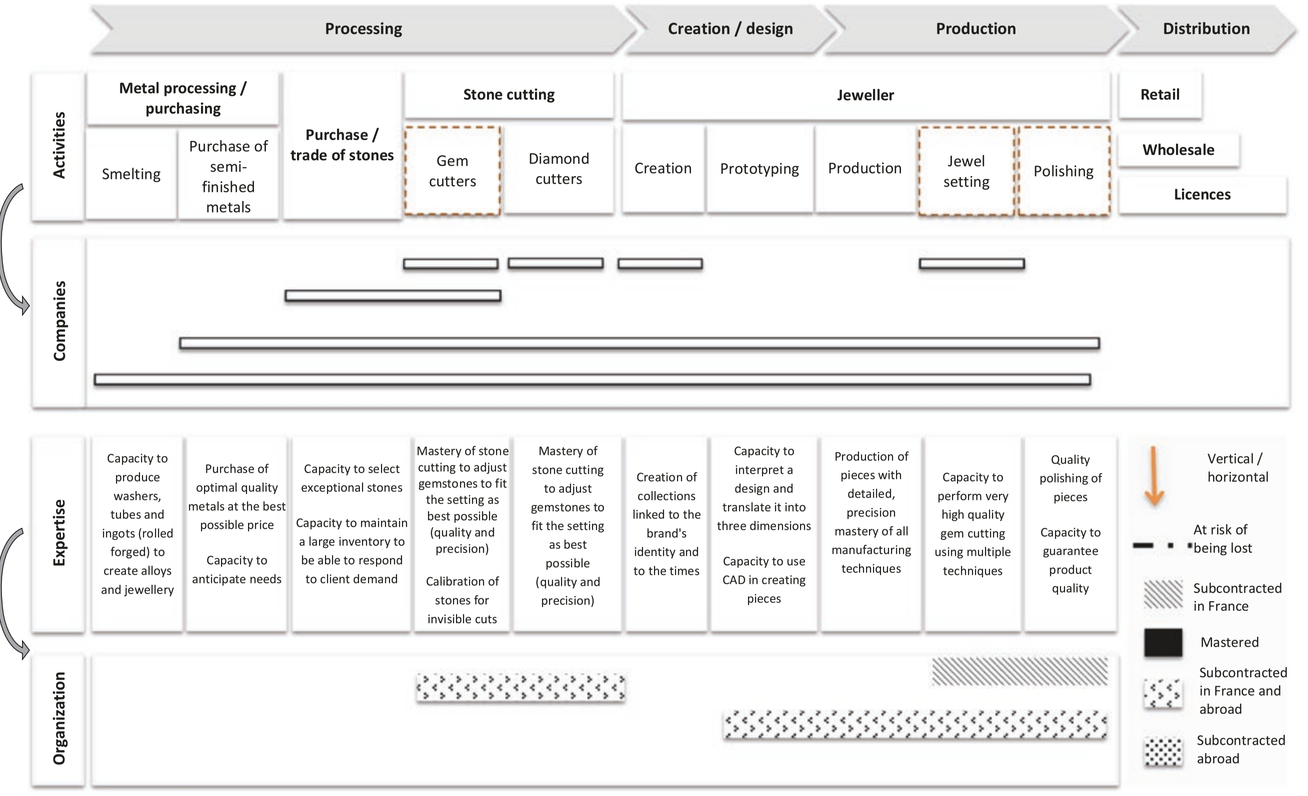



Fig. 8.3 Jewellery value chain: focus on knowhow

tions: shop versatility, support from training bodies, use of certifications, partnerships with education or by internalizing learning programs etc.

For example, as it was losing skills due to problems with replacing retiring workers, the luxury leather bag maker Mulberry worked with a local training college in England. This partnership led to an apprenticeship programme that provided Mulberry with suitable new recruits.

The French company Repetto is renowned for its ballet and dance shoes, manufactured using the unique "stitch and return" process, which requires the transmission of specific knowhow. In 2012, the firm set up its own training centre: the Repetto School. The school recruits unemployed people and spends several months teaching them different techniques. These newly qualified workers are then employed in Repetto factories. This strategy enables the company to face increasing product demand and competition by strengthening its qualified workforce, thus producing more while retaining traditional manufacturing methods.

Hermès employs more than 11,000 people worldwide. Its substantial growth in recent years has increased its need for production workers. The training of leather craftspeople takes two years on average. In 2014, Hermès set up a training centre near Paris for leather techniques, enabling the company to maintain use of in-house skills and knowhow in all its workshops.

In France, maintaining expertise is obviously connected to the incomparable quality and reputation of French craftspeople, but also to the need for a local presence, the challenge of innovation and the importance of ensuring the consistency of the brand's attributes by maintaining the entire value chain in France. This helps to transfer the values of artistic professions—such as giving sense, fraternity, social links and traditional skills—across generations. Nevertheless, contrary to preconceptions, expertise is not just inherited from craftspeople and entrepreneurs transmitting their art across generations, but is also reinvented each day in an ever more demanding environment. Historically rooted in specific areas and a driver of the "Made in France" label, expertise, if not monopolized by the luxury sector, is now inseparable from this strategic, economically dynamic global industry. Moreover, expertise is crucial to the industry. Attempting to map out expertise, to identify the public policies that need to be promoted, and to develop

strategies to preserve the different sectors of the luxury goods industry, is a challenge; luxury is such an elusive concept: "Luxury has its own logic, which cannot be reduced to rules, involving as it does desire and not need" (Le Luxe, Jean Castarède 2012).

Value chains enable the production of luxury goods that reach customers via distribution channels. At this level, skills and capabilities also face challenges. All business and management jobs (e.g., marketing, sales, finance, accounting, supply chain, human resources, IT, supply chain and customer relations) are expected to change greatly over the coming years in all sectors. The emergence of social networks and digital communication has changed the format of client interaction and led companies to employ people to develop this area. As an illustration, the number of jobs in communication and production design inside luxury companies has grown because communication budgets (20–25 per cent of their business income) have increased (Déchery 2013). Digitalization allows customers to co-create their own experience. Luxury brands create locations offering a unique "shopper experience" by paying careful attention to ambiance and design (Marchand 2016). This requires new jobs in brand and customer community management (e.g., brand ambassador, brand operations manager, brand specialist, brand executive, brand coordinator), which entail creating contents to promote the brand and get closer to customers. The different forms of social media have created many new roles, such as community manager, social media analyst, social media strategist and media manager (EY and Linkedin Survey 2014).

New categories of jobs have emerged from the latest ways to interact with consumers (e.g., chief experience officer or client success manager) and big data means a "new era of value" for the luxury sector (IBM chairman and CEO Ginni Rometty, in a keynote address for Forbes (2014), which included a discussion on the topic with Macy's CEO Terry Lundgren). Access to a huge amount of information and opinions makes the consumer much smarter and more critical than before. Additionally, information about consumers that is already available is now easy to compute thanks to the latest technologies. Macy's CEO Terry Lundgren says big data is a "retailers' competitive advantage", enabling closer client experiences (How Big Data Helps Stores Like Macy's And Kohl's Track You Like Never Before, blog post interview, 2014 retrieved from Forbes).

Developments such as globalization and e-commerce affect manufacturing processes directly (e.g., supply chains have to deal with time constraints and the need for items to be permanently available; the growth of limited—"capsule"—collections demands greater reactivity in material procurement). In addition to the need to develop competencies to react to these situations, new jobs are emerging in the effort to professionalize planning (e.g., production/distribution planner) (EY and Linkedin Survey 2014).

The dynamic of jobs and occupations in the luxury sector requires attention to be paid to employability. Employability is a multidimensional concept (Clarke and Patrickson 2008): it involves different notions, such as competencies, career readiness, and the ability to deal with different job factors such as agility in the job market (i.e., the ability to move from one job to another) or professional versatility (e.g., in a workshop). Workers in luxury markets need to deal with challenges such as: mobility across changing technical and social practices, the need to always improve service quality, remaining rooted in economic reality and connections with public policies. Employability guarantees are also important for the continuity of the value chain.

Developing sensitivity and knowledge about traditional values and the value chain in the luxury sector, and keeping abreast of new insights, help professionals to develop appropriate competencies. Jobs in marketing, sales and branding are the same for many industries. Therefore, to build successful professional trajectories in the luxury sector, a combination of academic studies and professional experience teaches students specific knowledge and competencies. For example, academic tracks specializing in luxury give students good training and skills for a variety of business and management positions.

Professional experience, case studies and learning by doing enhance practical knowledge and help to build a focused luxury curriculum. O'Leary (2014) emphasized how engagements with employers can develop a student's employability and reduce the gap between graduate abilities and employer requirements. Students improve their employability by working on consultancy projects for companies in the luxury sector. This kind of mission gives them experience of real issues such as the challenges of the value chain and changing customer needs,

commitment as identification and involvement with brand values (Kimpakorn and Tocquer 2009).

To conclude, promoting skills and jobs requires a combination of collaboration with public policies, companies' needs, education and promotion (career opportunities and guidance, training opportunities, etc.).

## Conclusion and Perspectives

Beyond the management prism and economic outlook, luxury is a sociological and psychological concept. Many now talk of the new frontiers of luxury: relations with the art world, the importance of experience and service, the development of ethical luxury, etc. Within this context, the future looks bright for creativity and the development of expertise and knowhow as competitive advantage. Knowhow is not a static concept but a dynamic process demanding various sources of information, strategic and applied, to develop sustainably.

Developing a real value-based philosophy and ensuring the availability of adequate resources requires insights from education; a combination of industrial and traditional approaches; moderation of the gap between manufacturing and management; and increased integration by reducing work divisions and balancing different logics.

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# 9

# Luxury & Prime Locations

Stéphane Fourneaux

Finance is a key factor of success in the luxury sector. In fact, from the design to the product distribution, a luxury company must have a solid financial structure to fund its projects and create value for its shareholders. The return on investment depends not only on the Four Ps—Price, Product, Place and Promotion—but also on the choice of the location: the fifth P of the marketing mix, the Prime location.

## Prime Location: Space is Luxury

### Definition

A prime address or a prime location is a term used by real estate professionals, which designates the best location in terms of quality, excellence and value. The quality of a location is measured by several criteria,

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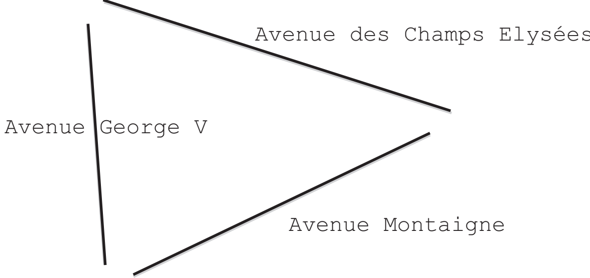


**Fig. 9.1** The luxury golden triangle—Paris

which are primarily physical and geographical: age of the structure, the number of square feet, exterior, landscaping, quality of construction, etc. With the help of these criteria, a luxury company can compare the quality of different locations in a dedicated area. In Paris, the combination of prime locations forms a luxury business district (LBD) called "the golden triangle". Prime locations belonging to these LBS are very expensive and have attracted major luxury brands. Fig. 9.1 mentions three famous avenues where luxury brands are located: the avenue of the Champs-Elysées, avenue Montaigne and avenue George V.

Particular property may also be chosen by luxury companies because the buildings strongly and efficiently advertise and promote their brand image. In this case, the real estate asset becomes a medium of their brand name, part of their corporate communication, also used to produce inflows.

## Prime Location: The French Palace Distinction

Consequently, the quality of the location can be considered as one of the luxury brand's attributes (see Fig. 9.2). The building, a real estate asset, which accommodates a luxury brand is also selected for the history of the site that only few real property assets have. This criteria of excellence helps luxury companies to attract clients with a high profile and purchasing power. Nevertheless, few locations or avenues in the world are historically ranked as a luxury benchmark. A location on 5th Avenue

« Established by the French Minister of Tourism in November 2010, the Palace distinction is designed to award official recognition to the finest 5-star hotels. They must have exceptional qualities that embody French standards of excellence and contribute to enhancing the image of France throughout the world. Criteria include: location, appearance, history of the site, character of the establishment, multilingual team, involvement of staff in seeking excellence, Fitness area, Spa, Gourmet restaurants »

Source: French Tourism Office

**Fig. 9.2** Prime Location: the French Palace distinction

in New York or the Champs Elysees in Paris is a sign of recognition and success for a luxury brand.

These locations allow them to assert their power at a national and international level (Wit 2010). and confirm their membership of the very elitist circle of the luxury industry. The address of a prime location is by definition unique and rare: a building on 5th Avenue in New York will not have the same market value as another building located near this street. The address gives a building its uniqueness and its character, as does the brand name for a luxury product. The address of a prime retail location is printed on business cards and all marketing material (Jones & Livingstone 2015). The more prestigious the address is, the highest market value the prime location has. This market value depends on the local market (Paris, Milan, London or New York for a world market) and is a barrier to entry for young luxury brands or mid-size luxury companies: only mature luxury firms may have access to high streets due to the costs and investments required to purchase or rent premises in a prime location. For all these reasons, secondary prime locations have attracted new brands, located also in very active business areas (i.e., new generation of prime locations like Upper East Side in New York or Le Marais in Paris).

## Buying or Renting Space

The prime location retail market is divided into two major markets: the market for the acquisition of prime location and the market for the lease of retail spaces. The market for space acquisition is not liquid (few deals per year) and offers expensive assets. By investing directly in real estate assets, the luxury company buys a "physical real estate asset" and thus becomes a retail space owner. This direct investment implies managing a real estate asset (maintenance, renovations, etc.) and investing money that cannot be used for financing new projects or other business activities. In this case, the acquisition of space may be motivated by a business opportunity (the owner sells a unique and rare address to its tenant, a luxury company) or strategic reasons (barrier to competitors in a unique retail area). This direct investment strategy is expensive (consumption of equity and debt) but may be profitable for the company brand name in the long term. In fact, it secures an address, by ensuring future cash flows without any rental constraints (renewal of leases).

By combining its brand name with a famous town and location (e.g., Harrods in London, Macy's in New York, LVMH in Paris) the luxury company perpetuates through time the brand equity at a local, national and international level. The acquisition of a prime location allows the luxury company to become the owner of a real estate asset, which may be leased (generating cash flows) and written on the balance sheet to facilitate the financing of new projects (side collateral).[1]

In reality, the ownership of a building is an option the luxury companies will not often exercise: a majority of large luxury brands rent their spaces rather than own them. There are several reasons that explain this choice: the acquisition costs, (lawyers, brokers, experts' fees and taxes), the management of a real estate asset, the financing, etc. Renting a prime location is less expensive and allows the tenant to avoid several constraints (i.e., management of space, repairs, collecting rents, etc.). Even if the rental of a commercial space is more commercially risky (e.g., lease contract may not be renewed by the owner), this approach is more flexible. In conclusion, both the acquisition and the rental of a prime location

[1] A real estate asset is a tangible asset that can be used as a guarantee to obtain a loan.

require taking into account strategic (buying an address), commercial (positioning) and financial (debt and equity) criteria. However, renting a prime location for luxury companies is less risky and costly and provides the right to use space, located at a unique and qualitative address, to make and generate profits by taking advantage of a powerful positioning.

## The Trading of Prime Rental Space

So, as just discussed, in most cases, luxury companies do not own spaces where their products are sold and distributed. They rent space leased by private investors and institutional owners.

### The Supply and Demand of Rental Retail Space

In normal market conditions, the supply and demand of space impacts the price per foot of a prime location: if there is a low supply and a high demand of space (a low or high stock of space), the price will be high. In contrast, a high supply and a low demand will impact negatively the rental price per foot. In fact, prime locations structurally disrupt the supply and demand of space at a local level, because there is always a strong demand focusing on rental space in the best location. The inflation of rental prices is maintained by different market players who trade and look for atypical and unique prime locations. The volatility of rental prices is also explained by the integration of a wide range of factors in the pricing process: market conditions, occupancy and vacancy rates at a local level, competition, taxation, deposit, etc. Thus, the selection of a prime location is based on different variables, which allow the calculation of the base rent and the effective rent.

### The Pricing of Rental Retail Space

The prime location is always the most expensive business place because the rental of a prime location allows professionals to take advantage of a highly profitable location selected according to three criteria: quality,

excellence and value. The very strong demand for this type of location leads to overpricing of the rent demanded by the owner. The rental price of a prime location is even higher than others because a prime location ensures the tenant a minimum expected return or cash flow per square foot. In other words, a prime location increases the probability of achieving financial goals (return, profitability) because the location is by nature attractive and appealing for doing business.

## The Base Rent and the Adjusted Rent

In the example below the EUMURIAN Luxury Brand has planned to rent 335 square feet at a prime location in Paris. The owner has considered the retail rental market, where his real estate asset is located and the price per square foot. The base rent obtained by the local market study is defined according to space requirement, volume rented, market conditions, etc. At the end, the prime base rent and given costs per square foot are calculated on an annual basis, $9,000 in our example (see detailed calculations Table 9.1).

The prime base rent ($251,250 per month) is adjusted by adding direct and indirect operating costs in order to obtain an adjusted more relevant and realistic prime base rent per month. In fact, the right to use space at a prime location, generates direct (security, taxes, insurance, electricity, etc.) and indirect costs that are added to the base rent. The future tenant has to list all the operating costs for a prime location, because they will affect outflows paid per month, as far as large areas are concerned. These direct and indirect costs cannot be underestimated because the calculation of future cash flows and returns on investment

**Table 9.1** Calculation of the prime base rent

| Cost per square foot (sq.ft.)/year | Volume square feet | Total |
|---|---|---|
| $9,000 | 335 | $9,000 sq.ft. × 335 = $3,015,000 |
| Prime base rent due per year | | $3,015,000 |
| Prime base rent due at the beginning of each month | | $3,015,000 ÷12 = **$251,250** |

**Table 9.2** Calculation of the adjusted prime base rent

| Cost per square foot (sq.ft.)/year | |
|---|---|
| Information obtained from the local market (Rent comparison approach) | Total |
| Cost per square foot (sq.ft.)/year (see Table 9.1) | $9,000 |
| **Additional rental costs in %** | **$9,000 sq.ft. × 7 % = $630** |
| **Direct costs: 7%** | |
| **Others in %** | **$9,000 sq.ft. × 3% = $270** |
| **Indirect costs: 3%** | |
| Adjusted cost per square foot/year | $9,900[a] |
| Adjusted prime base rent due per year | $9,900 × 335[b] = $3,316,500 |
| Adjusted prime base rent due at the beginning of each month | $3,316,500 ÷ 12 = **$276,375** |

[a]$9,000 + $630 + $270
[b]Volume = square feet

(profitability) may be inaccurate and lead to underestimating operating expenses: a mispricing may disturb the decision-making process by selecting a non-profitable prime location. In the example in Table 9.2, operating expenses (direct and indirect costs) affect the rental cost[2] per square foot by 10 % and consequently outflows on a yearly basis.

Firstly, the future tenant has to collect information, then check and spend time analysing it in order to obtain an accurate adjusted prime base rent per location. Secondly, the tenant has to select similar locations, recently rented, to compare them in terms of rental and direct and indirect costs, and eventually make a final decision based on the most profitable location.

## Effective Rent and Prime Location Selection

With the rental comparison pricing method, the luxury company (EUMURIAN Luxury Brand in our example) operates by selecting prime locations of the same nature that have been recently rented. This method, which may be adapted according to the location, is based on a local market study to identify the most significant deals

[2] We have not included in our calculations salaries and mortgage costs.

usually called "terms of comparison"(Rhodes 2014). Then, data from deals made and transactions done on the local rental market, with the same characteristics (volume of space, construction) and similar locations (in the same business area), will be compared with each other. The disparities between locations will be taken into account and the luxury company will make rental price adjustments based on these differences: at the end, the method attributes an effective prime rent per location. These two distinct and complementary approaches are explained in the following example: the selection of a prime location by comparison (approach 1) and the calculation of the effective prime rent (approach 2).

## Approach 1: Selection of a Prime Location by Comparison

During this approach and as detailed in Table 9.3, operating expenses (rent costs) are subtracted from operating revenues (sales). The profit obtained per prime location will be analysed and calculated according to different scenarios (optimistic, realistic, pessimistic). On the revenue side, the flow of clients per hour and the number of sales per square foot

**Table 9.3** Prime locations in Paris selected by the EUMURIAN Luxury Brand

| Type of location | Prime | Prime | Prime |
|---|---|---|---|
| Address | Location 1 | Location 2 | Location 3 |
| Brand name | COGITO | ERGO | SUM |
| Tenant size | 335 sq.ft. | 560 sq.ft. | 250 sq.ft. |
| **Expenses** | $9,900 | $8,000 | $10,000 |
| Adjusted rent Cost per sq.ft. | | | |
| Original lease term | 5 years | 9 years | 5 years |
| Market rent | $9,000 | $7,000 | $9,000 |
| Predicted rent growth or Expected CPI | 1 % | 1 % | 1 % |
| **Revenues** | $13,000 | $15,000 | $12,000 |
| Sales volume per sq.ft. | | | |
| Profit per sq.ft. | $13,000–$9,900 = **$3,100** | $15,000–$8,000 = **$7,000** | $12,000–$10,000 = **$2,000** |

are estimated[3] (Bainbridge 2014) to define the amount of value the luxury company may expect to create in the following years (a five-year lease period in our example). The calculations are easier with a prime location because it ensures a minimum flow of pedestrians and guarantees a minimum level of turnover or sales. In fact, lots of financial data are available and provided by market participants due to historical databases as far as prime locations are concerned (benchmark in the real estate industry).

## Approach 2: Calculation of the effective prime rent

The EUMURIAN Luxury Brand has selected location 1 (Cogito) for many reasons (profitability, value created, etc.) and used information from the local market to define its future cash flows. During this approach (see Table 9.4), inflows and outflows are adjusted by taking into account the time value of money (TVM)[4] and expected inflation (CPI).[5] The financial projections are made and based on the lease term, the number of years defined in the lease contract (five years in our example).

Table 9.5 summarizes the key financial information managers obtained after data reprocessing and used to calculate and measure value created per month and per year.

Once calculated, managers will compare their results (inflows and outflows) with their industry standards by using a balanced scorecard to gauge their performances over time. Through comparisons and trend analysis, managers can further identify key areas of weakness and improve both financial and marketing strategies in order to deliver and create more value per location.

[3] The geomarketing may be used to determine the potential of commercial development for a geographical business area.

[4] The time value of money (TVM) explains that one dollar available today is worth more than the same dollar tomorrow, due to its potential earning capacity (money can earn interest).

[5] The consumer price index (CPI) measures inflation, the price change of a weighted average basket of consumer goods and services. Changes in CPI give information about the cost of living and purchasing power.

**Table 9.4** Projection and calculation of the adjusted prime rent

| YEAR | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|
| Adjusted rent Cost per sq.ft. | $9,900 | $9,900 | $9,900 | $9,900 | $9,900 |
| Predicted rent growth or Expected CPI | 1 % | 1 % | 1 % | 1 % | 1 % |
| Adjusted rent per sq.ft. Increased by expected CPI 1 % per year | **$9,900** | $9,900 × 1.01 = **$9,999** | $9,999 × 1.01 = **$10,099** | $10,099 × 1.01 = **$10,200** | $10,200 × 1.01 = **$10,302** |

Average adjusted rent per sq.ft. including CPI:
($9,900 + $9,999 + $10,099 + $10,200 + $10,302) ÷ 5 = $10,100.
Present value of average adjusted prime rent/sq.ft. including CPI:

$$PV = \frac{\$9,900}{(1+0.9)^1} + \frac{\$9,999}{(1+0.9)^2} + \frac{\$10,099}{(1+0.9)^3} + \frac{\$10,200}{(1+0.9)^4} + \frac{\$10,302}{1+0.09^5}$$

PV = $9,082.56 + $8,415.95 + $7,798.28 + $7,225.93 + $6,695.59
PV = **$39,218.33**
Effective prime rent:
Present value (PV)= −$39,218.33 interest (i) = 9 %
Number of years (n) =5 Future Value (FV) = 0
Solve for payment **(PMT)** (We use a financial calculator to solve this problem) = **$10,083**

**Table 9.5** An example – A prime location term sheet

| Building name | Le BOURSIER |
|---|---|
| Address | 69 Charlot Street |
| City | PARIS |
| Total units | 335 sq.ft. |
| Analysis start date | 04/16/16 |
| Discount rate | 9 % |
| Rent costs per year | (**$10,083** × 335) = $3,377,805 |
| Monthly rent | ($3,377,805 ÷ 12) = $281,484 |
| Lease term (years) | 5 years |
| Predicted rent growth or expected CPI | 1 % |
| Sales volume per sq.ft. on a yearly basis | ($13,000 × $335)= $4,355,000 |
| Sales volume per sq.ft. on a yearly basis | ($4,355,000 ÷ 12) = $362,917 |
| Profit per Year | $4,355,000 – $3,377,805 = **$977,195** |
| Profit per Month | $362,917 – $281,484 = **$81,433** |

## Conclusion

As a luxury company, the firm has to generate and make profit by managing its sales and costs. Both expenses and revenues are sensitive to location that may significantly impact the organization's profitability. In fact, space is mainly leased and not owned by luxury companies. The study and analysis of the local market help managers to identify profitable locations, by comparing and calculating adjusted rent price and effective prime rent. The lease term, the space requirement, the time value of money and inflation may affect future cash flows (plurial) and are used to calculate rent payments (outflows) and revenues (inflows) for a medium and long term period (lease term). The luxury companies have to find the best combination between their business model and profitable locations in order to create value for their shareholders: we call it the fifth P of the marketing mix.[6]

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[6] Price, Product, Place, Promotion and Prime location.

# Part 3

## Key Processes for Value Creation in Luxury Companies

# 10

# Managing the Creative Process

**Paola Bertola, Chiara Colombi, and Federica Vacca**

This chapter focuses on the luxury fashion sector, introducing its characteristic business models and presenting the management of creative processes oriented to develop a strong brand strategy through a coherent stylistic identity.

In the first part, referring to the emerging perception of luxury and its different nature compared to past paradigms, it introduces the concept of culture-intensive industries[1] and their importance in contemporary luxury markets, highlighting the contribution of design in embedding cultural contents into luxury goods.[2] Considering the bond between culture and material production, innovation in fashion is defined as the ability of a product to be closed to the symbolic and cultural stimuli of its environment, so the designer becomes a creative

[1] Hesmondhalgh, David. *The Cultural Industries*. London: Sage, 2002.

[2] Bertola, Paola et al. "The Cultural Dimension of Design Driven Innovation. A Perspective from the Fashion Industry". *The Design Journal* 19(2). (2016): 237–251.

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intermediary, offering not a subjective view but rather a codified design approach through which to develop and share new cultural meanings.[3] Fashion design is therefore referred to as the interpretation of contemporary culture, in its tangible and intangible expressions. Fashion has developed an original design research practice—referred to as trend research—that aims not only to grasp new cultural elements but also to offer a new reading of contents and meanings of reference to modelling and interpreting cultural contexts. It organizes new contents and values into new products mixes, aligned with contemporary market trends. The contemporary luxury market strives for a progressive product iconization that allows brands to balance permanent and seasonal rules in order to create elaborate and unique interpretations of market trends. At this stage heritage management and design strategies aim at translating brand heritage into product narratives, strengthening products' iconization.

The second part of the chapter introduces research and product development processes in relation to major business models in the luxury fashion industry. It details the typical flow of product development processes together with related activities, actors, roles and specific outputs. Moreover, it presents a general overview of different design management models affecting the luxury industry and emerging paradigms into a polarized economy, between fast and slow fashion,[4] that are leading this sector towards new possible scenarios.

Finally, the chapter introduces some emerging paradigms within fashion and luxury coming from the observation of creative start-ups founded during the last ten years.

[3] Krippendorff, Klaus. "On the Essential Contexts of Artifacts or on the Proposition that 'Design Is Making Sense (of Things)' ". *Design Issue*, 5 (2), Spring (1989): 9–39.

[4] Fast fashion is a business model oriented to the reduction of collections' time-to-market and based on a pull supply chain, resulting in multiple collections' releases along a season, constant stylistic updates according to current fashion trends, low to moderate price positioning, and high product turn over and product scarcity in stores.
Slow fashion is an approach oriented to more sustainable creative, production and consuming cycles, looking for higher qualitative processes and more conscious consumption behaviors.

## Culture, Innovation and Luxury Contents Generation: Design and Trend Research Practice

Considering the new meanings of contemporary luxury and the progressive transition of its core values from a tangible dimension to an intangible one, as previously introduced in Chap. 1, we are looking at a paradigmatic shift in the positioning and consumption of luxury products through the cognitive processes of individuals in their relationship with luxury goods. This is contrary to real or staged experiences, which were considered to be the differentiating factors in the early 2000s.[5]

The focus on cognitive and narrative bonds created in the relationships between consumers, luxury goods and the contexts in which they take place introduces the concept of "culture-intensive goods".[6] Those are artefacts embodying "high cultural contents" as symbolic and evocative consequences produced by collective processes of elaboration within social communities[7] that play an active part in the definition of identities of those groups and their members. Therefore, such artefacts are considered "cultural products"[8] and rely on the existence of multiple and different "cultures" more than on a "culture" as knowledge resulted from an intellectual process, as was thought before the revisions of anthropological studies from the twentieth century. Moreover, culture intensive artefacts are historicized—meaning they show the historical evolution of their shapes, functions, manufacturing techniques and processes, and the identity of their creators, them being individuals or organizations/brands— and institutionalized in everyday life—as they contribute to defining individuals' lifestyles, being shared and accepted as familiar and

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[5] Pine, Joseph B. and Gilmore, James H. *The Experience Economy.* Boston: Harvard Business School Press, 1999.

[6] Hesmondhalgh, David. *The Cultural Industries*. London: Sage, 2002.

[7] Foucault, Michel. *The Order of Things: An Archaeology of the Human Sciences.* London: Tavistock Publications Ltd., 1970; Latour, Bruno. *We have never been modern*. Cambridge, Massachusetts: Harvard University Press, 1993; Landowski Eric and Marrone Gianfranco (eds). *La società degli oggetti [Society of Objects]*. Rome: Molteni, 2002.

[8] Volonté, Paolo. *Oggetti di personalità [Objects with Personality]*, In Volonté, Paolo And Mattozzi, Alvise (eds). *Biografie di oggetti [Biographies of Objects].* Milan: Bruno Mondadori, 2009.

relevant to a community. They also act as identity prostheses within the relationship that define the individual identities towards collective ones.[9]

In this framework, the factor that differentiates luxury products from mass market ones does not rely on tangible elements—such as preciousness and rareness of raw materials; intrinsic quality of manufacture; and distinctiveness and exclusivity of the very products—neither on the level of uniqueness, individuality or personalization of the experience enabled through consumption. Their differentiating factor lies not only in their nature of culture-intensive goods but also their ability to transfer the process dimension of their ideation and creation and, moreover, to deliver the transparency of those processes. This dimension is what Pine and Gilmore have defined as "authenticity",[10] as correspondence between a product's characteristics and the level of quality and truthfulness of the related processes, and as the importance that has in moving the discourse on consumption from consumerism to cultural exchange. The desire for authenticity defines new factors that contemporary luxury goods need to consider such as the environment, society and economic sustainability.

Within this perspective, design represents a privileged practice of exploring socio-cultural and symbolical issues in order to make sense of things.[11] We move from one of the first definitions of design-driven innovation, from Verganti in 2002,[12] according to which the innovation driven by design can result from the identification of users' new needs and a new market or from the application of a new technology into an existing product—a definition that actually is still connected to the idea of a market-driven innovation and a technology-driven innovation—to embrace Krippendorff's statement and the idea that design aims to develop a storytelling of cultural meanings and to stimulate new sense-making processes within a given socio-cultural context.[13] Design—

[9] Bertola, Paola et al. "The Cultural Dimension of Design Driven Innovation. A Perspective from the Fashion Industry". *The Design Journal.* 19(2). (2016): 237–251.

[10] Pine, Joseph B. and Gilmore, James H. *Authenticity. What Consumers really want.* Boston: Harvard Business School Press, 2007.

[11] Krippendorff, Klaus. "On the Essential Contexts of Artifacts or on the Proposotition that 'Design Is Making Sense (of Things)'". *Design Issue*. 5 (2) Spring (1989): 9–39.

[12] Verganti, Roberto. "Gestire l'innovazione design-driven" *[Managing Design-Driven Innovation]*. In Zurlo, Francesco et al.. *Innovare con il design [Innovating by Design]*. Milan: Il Sole24Ore, 2002.

[13] Bertola, Paola. "Embedding Meaning in Products". *Affective Human Factors Design Conference*. London: Asean Academic Press, 2001; Bertola, Paola and Teixeira, J. Carlos. "Design as a

being based on human-centric inputs, focused on a sense-making process, and delivering systemic and multidisciplinary outputs—acts as mediator between cultural contents and material production, and it supports the embodiment of intangible concepts into products.

The search and codification of new contents and values is therefore one of the most important activities that a design practice needs to carry out. Among the different design-oriented sectors, fashion design, in particular, has historically developed and implemented specific methodologies and tools to grasp meanings developed and recognized as relevant by a specific community, to read those elements and later release them by designing a fresh interpretation of them in the form of a new product. A product that is designed and envisioned through evolutionary trajectories of values for an evolving cultural context. Such practice, known as trend research, refers to the idea that innovation in fashion is defined as the ability of a product to be closed to the symbolic and cultural contents of the system of reference so that it has a design and culture-driven dimension.

From the birth to the ready-to-wear fashion system, along its evolution in the second half of the last century, trend research has answered to different needs. Starting in the early 1960s as a collective planning strategy, managed by trade fairs, such as Premiére Vision, through a process of "concertation" of a "dominant design", with the aim of reducing the risks and maintaining a leadership position for the whole textile supply chain,[14] trend research later assumed the role of predicting upward or downward shift in consumers' tastes, preferences and consumption behaviours within the debate between trickle-down theory and a bubble-up theory, between distinction and imitation, mainstream and subcultures.[15] In the

Knowledge Agent. How Design as a Knowledge Process is Embedded in Organization to Foster Innovation". *Design Studies*. 24 (2) (2003): 181–194; Verganti, Roberto. *Design-Driven Innovation*. Boston: Harvard Business School Press. 2009; Norman, Donald and Verganti, Roberto. "Incremental and Radical Innovation: Design Research Versus Technology and Meaning Change". *Design Issues.* 30 (1), (2014): 78–96.

[14] Rinallo, Diego; Golfetto, Francesca and Gibbert, Michael. "Consocia et Impera: How French and Italian Fabric Producers Cooperate to Conquer the 'Dominant Design' in the Fashion Industry". In Gibbert, Michael, and Durand, Thomas (eds.). *Strategic Networks*. Hoboken: Wiley-Blackwell, 2006.

[15] Simmel, Georg. "Fashion", *International Quarterly*, 10 (1), October (1904): 130–155, reprinted in *American Journal Of Sociology*, 62(6), May (1957): 541–558. Veblen, Thorstein. *The Theory of the Leisure Class: An Economic Study of Institutions*. New York: The Modern Library, 1934 (1899).

1980s, at the peak of ready-to-wear, trend research looked at the cyclic nature of fashion and the diffusion of new stylistic contents according to Roger's model.[16] Today, given the organizational complexity and global dimension of markets and supply chains, consumers' higher consciousness and independent capacity for choice and increasing level of competition, both at national and international level, trend research navigates the creative and product development phases through:

1. Observation of contexts in which cultural contents are produced—such as socio-political systems (political movements, cultural mainstream and underground systems, consumption phenomena, etc.), which read the evolution of values and behaviours in collective imaginary and refer to socio-cultural representation; core cultural industries[17] (art, literature, film, record industry, entertainment industry, etc.), which produce textual, visual and experiential contexts on a symbolic and aesthetic level; and consumption goods industries (architecture, product design, furniture, arts and crafts, graphic design, publishing, automotive, food, beauty, etc.) to track symbolic, aesthetic and perceptive evolutions/innovations.[18]
2. Data grasping.
3. Data analysis in order to recognize patterns in consumers' behaviours that can represent the so-called Zeitgeist, "the spirit of the time", and revealing predominant cultural trends in a certain age.[19]
4. Interpretation of elements of differentiation/evolution in order to connect them to their potential contexts of end-use.
5. Therefore realizing an abductive sense-making process into qualitative synthesis of contexts that may express the contemporaneity. This qualitative approach that looks for the evolutionary reading of values

[16] Rogers, Everett M. *Diffusion of Innovations* (3rd ed.). New York: Free Press of Glencoe, 1983.

[17] Hesmondhalgh, David. *The Cultural Industries*. London: Sage, 2007.

[18] Colombi, Chiara. "La ricerca di ispirazione: orientare il progetto *[Research for Creative Inspiration. Orienting the design practice]*". In Bertola, Paola and Colombi, Chiara (eds.). *MetaModa. Percorsi di ricerca per il design del prodotto moda [MetaFashion. Research Path for fashion Design]*. Santarcangelo di Romagna: Maggioli, 2010.

[19] Vinken, Barbara. *Fashion Zeitgeist: Trends and Cycles in The Fashion System*. Oxford: Berg Publisher, 2005.

and social and consumption behaviours needs then to be embodied into the actual design and further product development phases, considering also market constraints.

The research is therefore complemented by a quantitative analysis and forecasting on the level of acceptance and appreciation in the market of a product's aesthetic and perceptive characteristics—such as colour and shape—in term of sales data—and to deliver ideas that can be shared and accepted by all stakeholders. Towards the proposal of new visions of contemporary culture, cultural concepts inform a product's aesthetic and symbolic characteristics: colours, materials, finishing, shapes and meanings. The product's relevancy is then related to its ability to be coherent, even in its newness, with the context that has generated the values embodied in the very product and that will receive the very product once released.

In this search for continuity between past, present and future yet in the urge for a future change—both verified by the merge of qualitative and quantitative analysis, and by a double temporal span of the research, from short-term to medium- or long-term—trend research is able to highlight signs of change in the present time, projected towards the future, and to describe the evolution of cultural behaviours, attitudes and languages. It aims at informing not only product design but also coherent product mixes that strategically balance permanent and seasonal rules, with progressively highly iconized products and fashion items, as the next paragraph will explain in depth.

## Design Processes within Luxury Fashion Brands

The shift from industrial economy to knowledge economy underlined the necessity for a new vision of organizations' hierarchy and process management.[20] Competitive business models are more and more characterized

[20] Rifkin, Jeremy. *The End of Work*, New York: G.P. Purtman's Son, 1995; Rifkin, Jeremy. *The Age Of Access: The New Culture of Hypercapitalism, Where All of Life is a Paid-For Experience*. New York: G.P. Purtman's Son, 2000.

by parallel and open processes, where new professionals, holding multidisciplinary competences and merging technical and design skills with managerial skills, are scaling the organizational hierarchy.[21] Once seen only as a technical function, design has started to become a key factor in decision-making process, reaching leadership positions within companies and often becoming a shared attitude among top managers.[22]

While those changes are characterizing global corporations, fashion and luxury companies are in a different condition for many historical reasons. The majority of them originally focused their competitive advantage on high quality in terms of functional and aesthetic features, and for years they have been led by "product-centred" visions while only more recently investing in structured strategic functions such as brand management, retail management and innovation and research.[23] They have traditionally been based on a model of a unique relationship among entrepreneurial and design capacity, functioning in a dual leadership structure where CEO and creative director share strategic and decisional processes. Many among the successful international fashion brands started from that peculiar dualistic model, being informally anticipators of what could now be called the design thinking-based organization.[24] In fact, they were led by a hierarchy where design and managerial processes were parallel and collaborative, integrating "analytical mastery and intuitive originality in a dynamic interplay".[25]

[21] Luski Aïm Deüelle. *Rhizomatic Thinking*. Israel: Resling Press, 2001; Florida Richard and Goodnight, Jim. "Managing for Creativity". *Harvard Business Review*. Boston: Harvard Business Press, July (2005).

[22] Bailyn, Lotte. "The Hybrid Career: an Exploratory Study of Career Routes in R&D". *Journal of Engineering and Technology Management,* 8 (1), (1991): 1–14; Souter, Nick. *Breakthrough Thinking, Using Creativity to Solve Problems*. London: Lewis, 2007; Hoffmann, Patrick *et al.* "A Contemporary Justice Perspective on Dual Ladders for R&D Professionals". *Journal of Product Innovation Management*. London: Wiley, 2016.

[23] Golfetto, Francesca and Mazursky, David. "Competence-Based Marketing". *Harvard Business Review*. Boston: Harvard Business Press. December (2004); Bertola, Paola and Colombi, Chiara. "Re-Branding Made in Italy: a Design Driven Reading". *Fashion Practice—Fashion Made In Italy* Special Issue. London: Bloomsbury. November (2014): 175–200.

[24] Verganti, Roberto. *Design-Driven Innovation*. Boston: Harvard Business School Press. 2009; Maffei, Stefano and Simonelli, Giuliano. *I territori del Design [The Territories of Design].*, Milano: Il Sole24Ore, 2002; Saviolo, Stefania and Testa, Salvo. *Strategic Management in the Fashion Companies.* Milan: Etas, 2002.

[25] Bertola, Paola and Teixeira J. Carlos; 'Design as a Knowledge Agent. How Design as a Knowledge Process is Embedded in Organization to Foster Innovation'. *Design Studies*, 24 (2): 181–194,

During their evolution, the increasing competitiveness of a growing economy and mass market production started to affect their positioning on international markets, and, in order to combat the saturation of markets, many companies focused on price competition. This was acted through two different strategies: on one side, starting delocalization processes; on other side, reengineering organizational and managerial structures. In many cases, the combination of those two actions has been revealed as unbeneficial in the long term. Delocalization, when not managed with a high control of supply chain, led to a cultural impoverishment of local knowledge networks, breaking connections among actors within industrial districts and reducing the capacity of companies in proactively renewing and differentiating their products. Organizational change, often based on models developed in different business contexts, generated a progressive separation of functions and roles that originally integrated organizational and design skills.

At the beginning of the twenty-first century, the fashion industry was highly transformed, but the most successful companies—the ones able to survive recurrent economic crisis—found different paths for this transition. They were able to set up a model where the old concentration of functions on few professionals was abandoned in favour of distribution of activities and allocation of responsibilities into new and more numerous roles, without forgetting the processes integration previously practiced. Moreover, they created new connecting roles—such as fashion coordinators, merchandisers and line builders— that were able to re-establish the typical interaction between management and creativity.[26] In fact, the current organizational model informing luxury fashion companies is able to keep the central role of research, design and development processes and integrate it, at any step of the product lifecycle, with the other two major strategic functions: communication and retailing.

At the level of brand management strategy definition, the seasonal cycle of product creation aims at adjusting qualitative and quantitative requirements, not only relying on the need to incorporate new trends

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United Kingdom: Elsevier Science, 2003; Martin, Richard. *The Design of Business*, Boston: Harvard Business School Press, 2006.

[26] Bertola, Paola and Colombi, Chiara. "Re-Branding Made in Italy: a Design Driven Reading".

and products contents. It is drafted with a rich contribution from retail functions that synthesize information regarding markets performance, brand positioning on different areas, strategic delivery planning in specific calendar opportunity (e.g., Chinese new year) or seasonal differences (e.g., European winter vs South American summer) and customer relationship management feedback. Moreover, product creation is accompanied by a coherent communication plan that presents new concepts and collections to customers as well as reinforces brand perception, putting specific and different communication actions in place at any step of product development process and through a careful integration of different media. As illustrated in Fig. 10.1, contemporary fashion companies are based on a three pillars model, where "product development and creation", "marketing development and retailing" and "communication planning and management" are run in parallel as major strategic business units. Their effectiveness relies on the connection among their leadership within strategic planning and decision-making processes, and the continuous coordination granted by hybrid managerial and creative roles such as brand managers, merchandisers, product managers and line builders.[27] This specific organizational recipe, balancing creativity and management within a complex horizontal hierarchy, is able to structure and perform a complete cycle of operations within the tight fashion calendar, as will be further explained in the following paragraphs.

## Collection Design and Merchandising

Among luxury goods, fashion collections are certainly characterized by three attributes, which differentiate them in terms of nature of product offer, lifestyle and product lifecycle management (PLM), production model and delivery planning.

Firstly, they are conceived as an entire small product portfolio: a family of new and/or renovated products that are launched on the markets two to four times a year. Despite the common perception, fashion is not the free land of creativity and a collection's architecture is planned since

[27] Granger, Michele M., *Fashion: the Industry and Its Careers*, London: Fairchild Books, 2012.

**Fig. 10.1** Strategic business units and actors in luxury fashion companies (*Source*: Revisited from "Fashion Industry Strategic Processes: a complex network of design+management functions and professions" in Bertola, Paola and Colombi, Chiara, "Re-Branding Made in Italy: a Design Driven Reading": 178. In Bertola and Colombi (2014)

the early stage of research and product development as a complex and coherent system, numerically defined to fulfil market requirements and create the ideal mix according the brand's profile and positioning.

Secondly, a fashion collection is designed, produced and delivered in six months, creating a PLM model where the obsolescence of products is theoretically planned in advance and the cycle is reiterated with strict timing, in accordance with an official seasonal calendar adopted by the retail system, which includes major trade shows, global fashion weeks, wholesale campaigns, retail seasons and end-of-season sales.

Thirdly, traditional luxury fashion brands are usually based on *planned* and *semi-planned production models*,[28] where goods are produced only after buyers' orders have been collected during wholesale campaigns. This reduces the risk of blind manufacturing but at the same time generates a higher level of organizational complexity, based on two cycles of production: a small-scale one, aimed at sampling the collection for the wholesale campaign to support buyers in their selection, often relying on in-house or locally-based industrial facilities; and a larger-scale one, sometimes outsourced to international partners and bigger supply chain networks, and then delivered to retailers (Fig. 10.2).

Those three conditions create the need for an accurate and efficient planning of product design and development processes and the contribution of a rich system of professionals.[29]

The season starts with a creative *briefing*, which summarize inspirational trends collected under the supervision of a *creative director* and his or her design team. As previously illustrated, inspirational concepts are developed from information gathered through visits to tradeshows, research travels and various trends sources. Trend research is aimed at creating a final synthesis of *themes*, each one materialized into *moodboards* that define a set of colours and visual inspirations—volumes, shapes, historical and artistic iconic references, specific stylistic elements and details, etc.—which will drive the product design process.

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[28] Saviolo, Stefania and Testa, Salvo. *Strategic Management in the Fashion Companies*; Vergani, Guido. *Dictionary of Fashion*. Milan: Baldini Castoldi Dalai, 2004.

[29] Craik, Jennifer. *Fashion: the Key Concepts*. London: Berg, 2009; Dillon, Susan. *The Fundamentals of Fashion Management*. London: AVA Publishing, 2011.

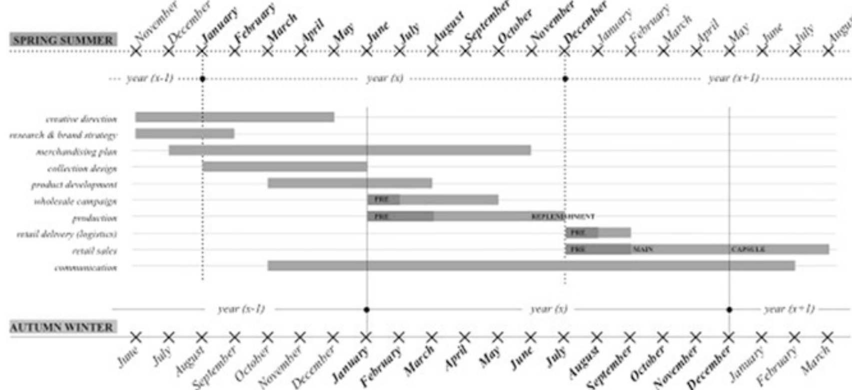


**Fig. 10.2** Calendar of a traditional fashion cycle (*Source*: Authors 2010)

While a creative team is working on trends, a brand management team is already becoming to be involved. The *brand manager* has a key role in fashion luxury brand. He or she supports both the CEO in developing the positioning strategies for a specific brand, and the creative director in implementing stylistic guidelines into a coherent products' portfolio. Moreover, the brand manager coordinates the whole design and development process, including in-house processes and licenses, to fit into an appropriate timescale.[30] At the beginning of the season, the brand manager supervises merchandisers' activities to complement the seasonal creative brief with a numerical plan, defining the first structure of the collection. A *merchandising brief* synthesizes the total number of models for each category (e.g., for apparel, number of trousers, tops, dresses, etc.), organized by occasions of use—within a classic structure of special occasion, work and leisure—and related to the number of sketches/styles created by the design department.

A numerical brief is firstly defined considering different sets of data, such as: structure and performance of previous collections (best sellers vs worst sellers); product positioning, considering also other brands within the company's portfolio and structure of main competitors' collections;

[30] Okonkwo, Uche. *Luxury Fashion Branding: Trends, Tactics, Techniques*. London: Palgrave Macmillan, 2007.

specific target markets and different markets positioning, with specific attention being paid to the expansion into new markets, and feedbacks from buyers and retailers.

Starting from that numerical brief, a *merchandiser*, under the supervision of brand manager, is in charge of implementing the collection architecture, strictly collaborating with the design team in order to ensure the right quantity of merchandise in an appropriate mix of products by categories and price, to fulfil retailers' requirements.[31] The merchandiser's main challenge is balancing the product portfolio structure in terms of nature of different product (between new and carry-over products); different occasions of use depending of customers' profiles; pricing goals and different market needs according to retail management requests, developing delivery plans that fit into different markets' calendars and lifestyles and considering the nature and capillarity of retail channels. Working with the design team, the merchandiser is in charge of incorporating four main ingredients in a collection:

– Permanent core products (*iconic products*), strongly representing the brand's stylistic identity.
– Renewed core products, as seasonal interpretation of core products, using new fabrics, colours and constructions.
– Seasonal products: newly introduced products based on seasonal trends.
– Basic products, satisfying basic needs, that often are considered complementary products.

Following stylistic guidelines defined by inspirational moodboards and within numerical constraints set by the merchandising plan, the design team creates a number of different sketches and technical drawings (or flats). Sketches are usually organized in two to four themes per collection, where groups of key items for each theme fulfil different needs in terms of lifestyle and occasions of use. Different options of the key items in terms of constructions and details are then developed. Concepts evolve and are applied in different ways to different styles to expand the product mix in a coherent way, creating a family feeling among different items. Sketches are finally translated into technical drawings.

[31] Clark, James. *Fashion Merchandising: Theory and Practice*, London: Palgrave Macmillan, 2014; Grose, Virginia. *Basics Fashion Management 01: Fashion Merchandising*, London: AVA Publishing, 2011.

The designed collection represents only an ideal set of products: it will sometimes deeply change through the process of development before reaching the stores.

## Product Development and Production

A *product manager* is in charge of supervising prototyping, fitting and sample collection production. He or she is a major protagonist in materializing the collection in a coherent and feasible way and they must be involved from the beginning of the design process. In fact, the product manager's involvement at the early stage of trend research is a key factor for providing the creative department with technical solutions and suggestions to fulfil their specific needs in term of materials, details, accessories and technical solutions required by the seasonal inspirational themes. At the end of the design process the product manager is involved, together with the creative director, brand manager, merchandiser and designers, in the selection and approval of styles that will be part of the final merchandising plan, and will be then prototyped and finally produced.

The product manager coordinates prototyping and fitting to test design concepts and constructions with materials. Prototypes are usually manufactured in in-house laboratories or in tested specialized laboratories where the product manager knows the technical staff very well and can supervise the quality of work. In fact, at the very early stage, prototyping also includes pattern making, which is a highly specialized skill that not all laboratories are able to provide.

When prototypes are finally approved by the creative director's and brand manager's teams, specs are filled with detailed information on consumptions of different materials and accessories, their prices and suppliers. Each style is produced in a number of units to create as many sample collections as needed for the different wholesale campaigns internationally managed at the company's and/or distributors' showrooms. As previously anticipated the majority of luxury fashion brands are based on planned production and delivery after collecting buyers' orders. In fact, styles are presented during the wholesale campaign through a sample collection and a full collection sales book. The product manager supervises only the small-scale production process related to sample collection while the

full-scale production is engineered and managed by a *production manager*. When orders are collected and total numbers of items for retail distribution are available, a different supplier is required than the prototyping laboratories as well as a(n) (outsourced) larger networks of producers.

While sample collection production is on-going, the merchandiser, in collaboration with the product manager, implements the full collection sales book, which will be offered to buyers to define all the different combinations and options in terms of style, material and variations in material colour. This final process, often called *fabrics-to-sketches*, is aimed at possibly rebalancing the whole product mix in terms of fitting (whether application of certain materials will change the way an item falls on the body and eventually require adjustments or modifications to constructions); occasions of use (whether the use of certain materials can satisfy specific functions); and pricing (whether the application of certain materials, embellishment and constructions can redefine cost and perceived price in relation to occasion of use).

The wholesale campaign is usually launched by the brand manager, merchandiser and product manager, introducing main concepts of the collection to the sales force and buyers for the company-owned shops. The combined use of sample collection and full collection sales books allows the sales force and buyers to preview all the possibilities available to customers, thanks to combinations of styles, fitting, materials and colours.

In answer to the fast fashion model introduced by mass-market competitors, the traditional spring/summer and fall/winter calendar has changed and several luxury brands are already running their cycle on four collections (two pre-collections and two main collections), with additional capsules to address specific selling events (i.e., resort, Christmas, Saint Valentine's day, etc.). Moreover, they are starting to plan their deliveries to retailers and creating product packages alongside the other elements of a merchandising plan. Those packages are conceived as sub-groups of the whole collection consisting of a selection of products and presented in shops at a different time within a season, to continuously refresh what is on offer and attract customers more frequently. These dramatic changes in fashion retail pushed by fast fashion brands are quickly reconfiguring the design and development process,[32] as it will be explained further in the following paragraph (Fig. 10.3).

[32] Tungate, Mark. *Fashion Brands: Branding Style from Armani to Zara*. London: Kogan Page Publishers, 2008.

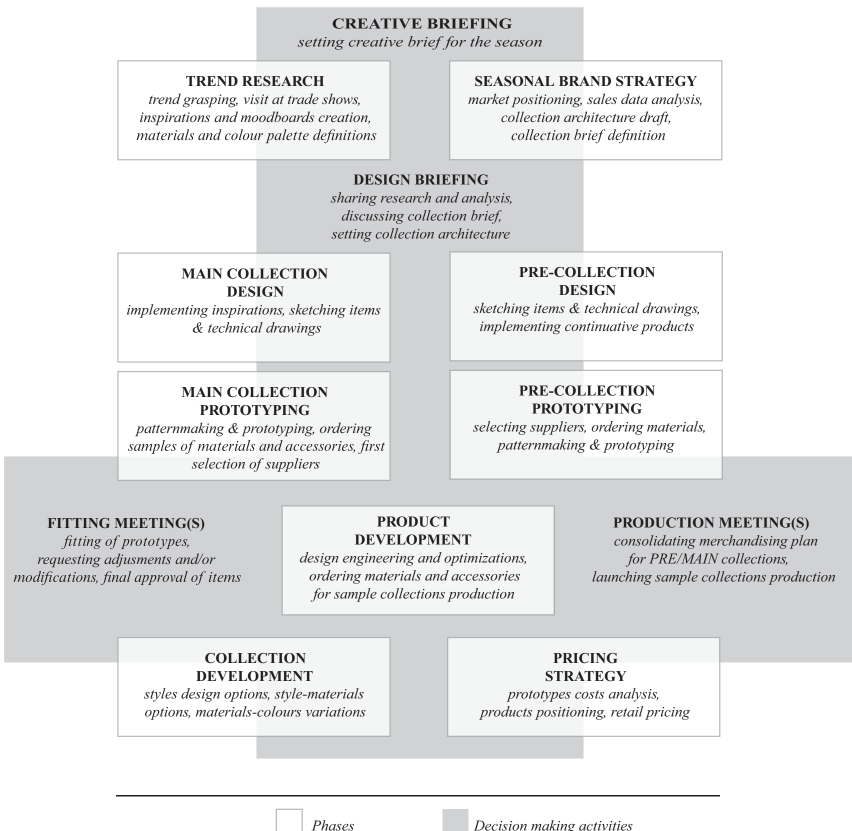


**Fig. 10.3** Design and development process (*Source*: Authors 2010)

## Between Slow and Fast Fashion: New Possible Scenarios for the Luxury Industry

The profound rethinking of the luxury sector, which is no longer able to support the new market logics and information and communication revolutions of the internet and social media, is therefore driven not only by the continuing request for highly innovative fashion but also by the need to shorten and compress the time that elapses between the presentation of a product or collection and its development and actual marketing.

The consolidated logic of the planned fashion models typical of ready-to-wear, presented in the previous paragraph, has been affected by the *fast fashion model*,[33] which develops a business strategy based on the concept of “fast pace” in order to maintain significant effectiveness and efficiency in the reduction of a collection’s time-to-market. Fast fashion companies—among which Inditex Group is often referred to as the innovator of the fast fashion business—move their strategy from a “product-centric” to a “market-centric” approach, where the strategic business of retail becomes the key asset that drives the whole process of creation, development, communication and sale of products.[34]

The key features that define fast fashion as a highly successful business model can be summarized as follows:

– *The variety of styles offered on the market*: the ability of fast fashion companies to constantly renew the product ranges with fashion-led styles and to offer a greater variety of sub-style collections in diverse product categories that can fit into different market segments and satisfy a wider variety of consumers. The strategy to offer something new in a very short time frame (almost every two to three weeks) makes the collection attractive for customers, who become willing to frequently catch up with the brand, visiting its store and looking at the new assortment.
– *The moderate price*: as the result of an efficient supply chain management and a constant monitoring of sell-out data. Through this strategy, a fast fashion company is able to control a collection’s production costs minimizing the risk connected to designing original products, thanks to a continuing re-briefing of collections according to same-store sales data or earlier collections’ sales data. They can control a collection’s engineering process, ensuring coherence among pricing, perceived value and production constrains. They can also control retailing and communication activities, avoiding placement or communication of products to the wrong audience or an inappropriate erroneous channel.

[33] Hines, Tony and Bruce, Margaret. *Fashion Marketing. Contemporary Issues*. Oxford: Elsevier, 2001; Cietta, Enrico. *La rivoluzione del fast fashion. Strategie e modelli organizzativi per competere nelle industrie ibride [The Revolution of Fast Fashion. Strategies and Organizational Models to Compete in the Hybrid Industries].* Milan: Franco Angeli, 2008.

[34] Bertola, Paola and Colombi, Chiara. “Re-Branding Made in Italy: a Design Driven Reading”.

– *The responsiveness to the market needs*: as the speed of offering a finished product to the market, intercepting dominant trends of the season or specific socio-cultural events that meet the expectations of society facing a rapid change of demand/supply. This aspect is primarily determined by the ability and flexibility of a company to reduce the processes involved in the buying cycle and the lead times, through a meticulous management of the entire supply chain and the entire product lifecycle.[35]

## Fast Fashion Supply Chain: What Has Been Changing

The fast fashion supply chain requires much more flexibility than the more traditional slow fashion one (see Fig. 10.4).

While the traditional production cycle is based on long-term forecasts and requires almost one year to develop a season, from the definition of the trend up to the last delivery,[36] the fast business strategy provides up-to-the-minute trends and styles to consumers at relatively low prices.[37] This is possible because the fast fashion model moves from a planned production to a hybrid production*,* in-between semi-planned and production "in the dark",[38] which combines some of the features of traditional planning with those of fast fashion. Each collection is segmented in capsules made of specific fashion contents/themes and they are targeted at different audiences.

The first collection launch includes basic items and contains the permanent selection offered by the company. It is produced in the dark, without the need of trends and data analysis, and it is constantly available in-store, season after season.

[35] Bini, Vittorio. *La supply chain della moda [Fashion Supply Chain]*. Milano: Franco Angeli, 2011.

[36] Saviolo, Stefania and Testa, Salvo. *Strategic Management in the Fashion Companies.*

[37] Bini, Vittorio. *La supply chain della moda [Fashion Supply Chain]*; Cietta, Enrico. *La rivoluzione del fast fashion. Strategie e modelli organizzativi per competere nelle industrie ibride [The Revolution of Fast Fashion. Strategies and Organizational Models to Compete in the Hybrid Industries]*.

[38] Cietta, Enrico. *La rivoluzione del fast fashion. Strategie e modelli organizzativi per competere nelle industrie ibride [The Revolution of Fast Fashion. Strategies and Organizational Models to Compete in the Hybrid Industries].*

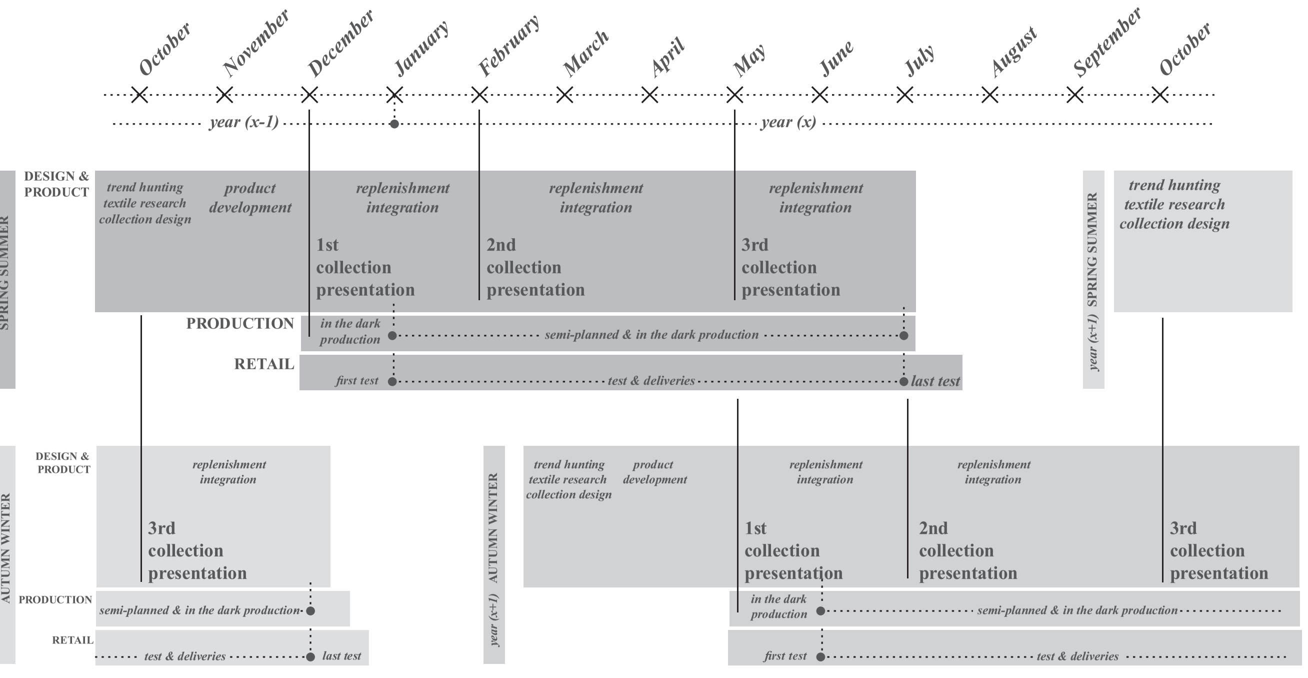


**Fig. 10.4** Fast fashion supply chain (*Source*: Authors 2012)

The mid-collections (the number changes according to the companies, but there are at least two or three launches) are semi-planned so they are designed according to the stylistic research done by the creative department—that very often consists only of a re-elaboration or simplification of the main strong ideas, looks or details seen during the latest fashion shows—and trends and data analysis. Those capsules are characterized by strong on-going trends. They are produced with a timing that in some way reflects the ready-to-wear calendar. They explore the seasonal creative core for the brand, introducing launch-by-launch updated novelties and developing best-seller products and themes.

Finally, the last collection launch is usually designed to incorporate selected items that are supposed to stimulate purchases during the sale season.

## Fast Fashion Creative Process

The main differences between a ready-to-wear collection and a fast fashion one are not only price positioning and supply chain management. Another very distinctive aspect emerges from the research and concept development approach and from the creative process that are mostly oriented towards a reproduction of inspirations and looks from major fashion brands "observed" through the meticulous analysis of their catwalks.

We can recognize five different creative approaches to fast fashion that can delineate an exhaustive picture of the phenomena (see Fig. 10.5).

The first one, named *fashion transfer*, is a creative approach that "transfers" the must-have trends and styles of the fashion shows to a lower quality and simplified construction. The productive process is based on the production in the dark for the basic collection, with continuous flash integrations of new styles, colours, prints and fabrics. An application of this approach can be seen at Asos, British online fashion and beauty store.

The second one, named *up-to-date*, is a creative approach that focuses on the concept of an "essential wardrobe" of basics items intended as a modular collection in which each item can be matched with other products from the collection to create an individual consumer's personal look. While the design content is not so distinguished because minimal changes

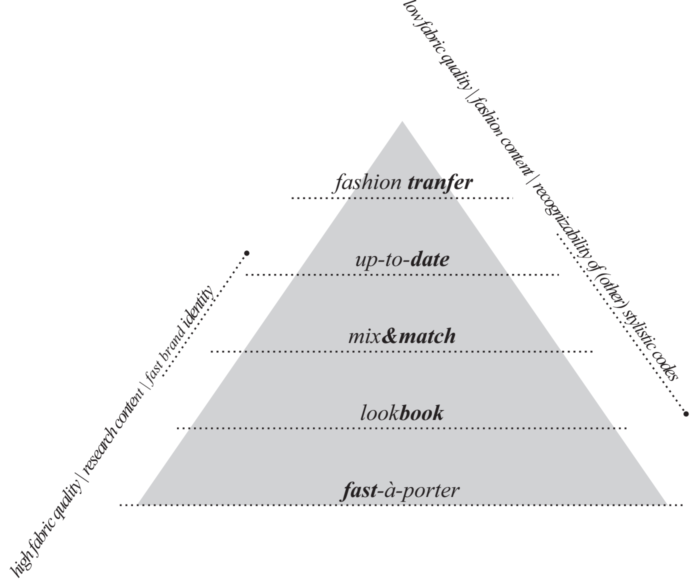


**Fig. 10.5** Interpretative model of creative process in fast fashion (*Source*: Authors 2012)

occur in pattern making, companies choose yarns and fabrics with higher quality, more accurate fitting and colour palettes that reflect seasonal on-going trends. The production process is manly based on a dark production with integrations and re-assortments of the same models, colours, prints and fabrics. The best example of this approach is represented by Uniqlo, a Japanese casual wear brand internationally distributed.

The third creative approach, named *mix and match*, refers to the concept of masstige, a combination of mass-market logics with the prestige of luxury.[39] The result is a limited edition capsule collection that presents high fashion contents developed by the fashion designer who signed the collection. It is temporary and exclusive and expresses a sort of democratization of high-end fashion into lower price items because of the use of a different quality of materials and manufacturing. The collection is supported by an aggressive and viral communication strategy, offering

[39] Bertolini, Anna. "Con il fast fashion i consumatori indossano la moda *mordi e fuggi. [Fast Fashion Consumers Wear Bite and Run Fashion]*". *MARK UP.* May (2008): 32–35.

previews of the entire collection on the web and social media in order to stimulate the "need to purchase" and to justify this special collection's premium price in comparison to the brand's average product. H&M collections demonstrate this approach well.

The fourth approach, named *look–book*, reinterprets the macro trend of the season in an autonomous and independent way, designing a collection in which product assortment and categories target a specific lifestyle and create a certain total look. This approach provides a vertical integration of the various functions that are localized in close proximity of headquarters in order to maintain tight control over them. The collection is split into different product lines, according to various themes, cost ranges, levels of quality and target markets. The production is semi-planned with a strong integration and re-assortment of part of the collection, according to feedback frequently sent by worldwide stores. Design, development and merchandising of ZARA collections are emblematic of this approach.

Last but not least, *fast-à-portér* is a creative approach that invests in research and design to create a strong brand identity, halfway between the logic of fast fashion and the quality of the high fashion. This approach follows the "high-low-match" trend, combining high-end designer pieces and fast fashion items.[40] So the collection is designed to be a perfect balance of timeless styles with strong fashion contents, produced using high quality materials or distinctive design. It combines the semi-planned production with the logic of distribution of fast fashion, requiring frequent refreshment and replacement with new products, also thanks to the integration of the e-commerce platform. COS and & Other Stories, both brands of H&M Hennes & Mauritz AB's portfolio, use this approach.

## The Need for Fast Luxury

The rise of fast fashion as a successful business model has led the traditional luxury companies to invest in strategy to emphasize the heritage of the brand itself and completely rethink strategies, timing, supply chain and collection launches. In this chaotic and complex situation, many

[40] Bertolini, Anna. "Con il fast fashion i consumatori indossano la moda *mordi e fuggi. [Fast Fashion Consumers Wear Bite and Run Fashion]*".

are the art directors of major luxury companies that have resigned from their appointments because of the undue stress they are subjected to in this vortex of information and products. Just to name some examples, Alber Elbaz was ousted from Lanvin, Raf Simons left Dior and Stefano Pilati left Ermenegildo Zegna. A new attitude that has been reinventing the fashion system has demanded rapid change in the traditional fashion system's dynamics, not only in terms of design and production, but also in terms of collection presentation and distribution. Internet and social media have in fact favoured the need to "just-see and buy" the fashion show outfits and many are the brands that, in different ways, are developing strategies to make that a reality. One example is Burberry who since fashion week 2016–2017 has been producing their entire collection in the dark (taking advantage of the lesson learnt from the fast fashion companies) and has offered the whole collection simultaneously in both selected flagship stores and through e-commerce websites, opening new opportunities beyond a traditional business model.

## Creative Start-ups Towards a New Concept of Luxury

Not only has the fast fashion business model affected luxury brands, but many paradigmatic changes, both in markets and manufacturing organizations, are deeply transforming the luxury business and starting to impact on traditional models of design management.

On the one hand, market conditions are drastically changing, affected by different lifestyles and attitudes of new customers, such as millennials. Many surveys conducted on this specific niche underlined a few relevant points. This age group are apparently much less influenced by traditional advertising and moreover tend to be less loyal to brands, searching for continuous engagement and interested in trying and testing different products. In addition, they are open to newness and unknown brands, where the narrative of the "new" is engaging and authentic, partaking of their values and lifestyle.[41] Finally, their access to goods and services is being shaped by a hybrid attitude where traditional and digital channels

[41] Howe, Neil, and William Strauss. *Millennials Rising: The Next Great Generation*. New York: Vintage Publishing, 2009; Nowak, Linda, Liz Thach, and Janeen, E. Olsen. "Wowing the

are merging within a unique cross-model while communication, social interaction and retailing are overlapping and blurring their boundaries.

With regard to contemporary manufacturing paradigms, globalization is generating unexpected feedback. Previous delocalization strategies are making way to reshoring processes where lower production costs are no longer paying back the difficulties in controlling quality and social impacts of outsourcing in emerging countries. Since the first half of the twenty-first century major international groups, among which are many French and Italian luxury groups, started to re-locate their operations closer to their country of origin, investing in regenerating local industrial know how and craft capabilities.[42]

Given these premises three major differences are characterizing contemporary emerging brands, in terms of nature of the very products, interaction between brands and their customers and, lastly, the way business models are shaped overcoming traditional organizational categories.

The changing nature of products relies of the characteristic attitudes of millennial customers, as previously introduced. Always digitally connected, they are detached from the seasonal fashion cycle and their buying attitude is satisfied by unique and engaging narrative of products and brand values. They often look for iconic products, real lifestyle symbols such as Marcelo Burlon's County of Milan, SUPER by Retrosuperfuture or Octopus, where season, gender and traditional product positioning are overtaken by almost mono-product brands, based on collectable, unisex and non-seasonal items, positioned as a new kind of "sportswear-à-porter".

Moreover, being digital natives and accustomed social media users, millennials seem to be uninterested in the traditional mythopoeia mechanism of luxury brands, fed by exclusivity and distance between creators and consumers. They expect to be involved by the brand they perceive as an open social platform, accessible and close to their daily lifestyle, in search

Millennials: Creating Brand Equity in the Wine Industry". *Journal of Product & Brand Management* 15(5) (2006): 316–323.

[42] Fratocchi, Luciano et alii. "Manufacturing Reshoring: Threat and Opportunity for East Central Europe and Baltic Countries". In Zhuplev, A. (ed.). *Geo-regional competitiveness in Central and Eastern Europe, The Baltic Countries, and Russia*, IGI Global. (2014): 83–118; Fratocchi, Luciano et alii. "When Manufacturing Moves Back: Concepts and Questions". *Journal of Purchasing and Supply Management*. London: Elsevier. 20 (2014): 54–59.

of an active and authentic cultural exchange, rather than for a passive consuming experience. As for brands such as CAMO by Stefano Ughetti or L'F Shoes, communication and retailing are merging within a unique complex system where the customer journey combines brand storytelling, social media interaction and e-commerce within a continuous flow.

Seen from a design perspective, these conditions challenge many traditional categories driving product development, such as timing (two cycles of development vs several cycles); seasonal structure of product mix (one collection with a wide assortment vs many collections with a focused mix); occasions of use (sportswear vs prêt-à-porter); and gender attributes (menswear/womenswear vs unisex). Moreover, they underline the desire of new customers to be engaged in the actual design process, being fully informed of its contents, making the traditional boundaries between product design and communication design disappear.

Not only should design management be reorganized by looking at the characteristics of contemporary customers and their specific attitude, it should also consider the way manufacturing systems have evolved throughout the last decades and survived the economic crisis after the crash in 2008. Global industrial networks linked to luxury fashion have been re-engineered to increase the quality of processes and products again, working on unique and differentiating attributes. This happened in response to homologation, which until the 1990s produced hard competition for mass-market products and customers' increasing awareness of the cultural and social impacts of outsourcing luxury product production to emerging countries. Traditional highly-qualified industrial districts, such as the Italian ones, saw a renaissance of investments in territorial qualification, both in terms of local craft knowhow and of innovation in manufacturing. Moreover, the conditions set by the economic crisis pushed all major companies to re-engineer their processes in order to be able to respond to market turbulences with flexible strategies.

Given these premises, start-ups funded by creative millennials are approaching design and manufacturing processes by taking full advantage of these transformations. The hybrid nature of their products and collections is in fact supported by hybrid business models, overcoming traditional categories. Brands such as Damir Doma, Casbia, Come for Breakfast and CO|TE exploit flexible design-driven networks, where

different local manufacturing systems are integrated, connected and coexist with global market access, granted by digital channels and social media strategies. Advanced manufacturing and craft production are merged into a continuous flow, which enables them to highly differentiate their products and to approach both small-scale and industrial series.

Fashion, being a fusion of business, culture and daily behaviours, is a privileged context in which to observe paradigmatic changes that are deeply transforming customers' values and lifestyle, the nature of contemporary products, and consequently manufacturing and distribution channels. This revolution is dramatically affecting design process planning and emerging brands seem to be quicker and more ready to embrace new models—overcoming combined concepts, such as local and global, small scale and series, craft and industrial production, season and gender, communication and retailing, digital and physical. All these signs may be relevant to the whole luxury industry and certainly need to be carefully considered by the main luxury brand players on the international markets when shaping their future strategies.

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# 11

# Supply Chain Management in the Luxury Industry

Alessandro Brun

This chapter will introduce the concept of supply chain and supply chain management, discuss the typical supply chain configuration of luxury companies and describe the planning and execution processes in supply chain management.

This chapter is organized as follows:

- The general definitions of supply chain and supply chain management, along with other relevant terms are presented in section "Definitions".
- A synthetic view of the current trends and challenges of the supply chain management, with special focus on the luxury supply chains is given in section "Trends and Challenges in Supply Chain Management".
- The typical structure of both the Inbound and the outbound supply chain are described in section "Typical Structure of the Inbound and Outbound Supply Chain".

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- Section "Typical Supply Chain Planning and Execution Processes" is dedicated to a synthetic description of all the "core" processes of the APICS[1] reference model (inputs, outputs, goals).
- Finally, to let the reader better understand the typical supply chain configuration of fashion-luxury companies, section "Noteworthy Examples of Supply Chain Configurations" discusses examples of noteworthy configurations taken from shoe, leather bag and underwear sectors.

## Definitions

A supply chain (SC) can be described as the set of activities that allow the transformation of raw materials into finished products, passing across suppliers, manufacturers, distributors and companies with other roles (Lummus and Vokurka 1999). Cox et al. (1995) identify the supply chain as the functions, within and outside a company, that enable the value chain to manufacture products and provide services to the customer. The Supply Chain Council (1997) stated that "The SC encompasses every effort involved in producing and delivering a final product from the supplier's supplier to the customer's customer". Childerhouse et al. (2002) speak of "Demand Chain" in order to highlight a *customer orientation*: "the whole manufacturing and distribution process may be viewed as a sequence of events with one purpose: to serve the ultimate customer". These are just some of the definitions that were provided for one of the most explored management concepts of the recent years: dealing with supply chains is now a necessity, dictated by the evolution of the economic scenario.

A typical supply chain consists of five main components:

- *Suppliers*. Source of raw materials, component parts, semi-manufactured products and other items that occur early in the supply chain—unfinished or non-consumable products.

[1] APICS is the leading professional association for supply chain and operations management and provides research, education and certification programmes aiming at supporting supply chain excellence, innovation and resilience (www.apics.org). At the moment, a specific reference model for planning and execution processes in luxury companies does not exist; yet the APICS model—conceived to work in a number of industry—fits perfectly well the specificities of most luxury companies.

- *Manufacturers*. Makers of products. Many consider them to be the heart of the supply chain. Actually, both suppliers and manufacturers are producers of products. Suppliers produce components or subassemblies, while manufacturers perform the task of final assembly or product integration.
- *Distributors*. Responsible for the packaging, storing and handling of materials at receiving docks, warehouses and retail outlets.
- *Retailers*. These are the manufacturer's customers—the stores that buy the actual products. Throughout this chapter, retailers will also be referred to simply as customers.
- *Consumers*. This is you—the person who goes into a store and buys the product.

Not all firms utilize this supply chain model, however. For instance, eCommerce allowed some manufacturers to bypass the distributors and retailers components of the supply chain completely. The company simply takes orders, pulls raw materials and components from inventory sent by its suppliers, and—once the end products are completed—ships the products directly to consumers.

A common approach to describing a supply chain consists in listing the business processes across it. The processes, beyond the physical operations required for making the products themselves, represent the route along which products are conceived and flow towards the end consumers. Normally, various actors along the supply chain (e.g., suppliers, outsourcers, third party logistics providers, retail partners, etc.) take part in these processes and in this way they can contribute (positively or negatively) to the alignment of the supply chain towards the key requests of the market (the so-called critical success factors (CSFs).

According to the Supply Chain Council, four basic processes—plan, source, make, deliver—broadly define these efforts, which include "managing supply and demand, sourcing raw materials and parts, manufacturing and assembly, warehousing and inventory tracking, order entry and order management, distribution across all channels, and delivery to the customer" (although latest versions of the Supply Chain Reference model developed by the Supply Chain Council encompass other processes, the four abovementioned remain paramount).

However, many authors have proposed their views for identifying more precisely the processes within a supply chain. One of the most recognized

models is provided by Lambert and Cooper (2000). They identify eight business processes, namely: (1) customer relationship management, (2) customer service management, (3) demand management, (4) order fulfilment, (5) manufacturing flow management, (6) procurement, (7) product development and commercialization, (8) returns.

## Trends and Challenges in Supply Chain Management

In many industrial sectors, demand in mature economies had a major surge after World War II—a period in which the production capacity installed in many companies never seemed to be enough.

Yet in the second half of the twentieth century, a number of changes took place that shaped the modern concept of supply chain management: the globalization of markets, reduced political tensions and the development of information technologies were all factors that made distances appear shorter, therefore pushing the competition on a global basis. Traditional companies soon realized that their survival was threatened, and most of them began to change. Arguably, the revolution started in the 1970s and took three decades to perfect.

- *1970s*. Companies started focusing on internal efficiency. Some western companies became aware of the total quality management (TQM) revolution happening in Japan since the 1950s (Ishikawa 1985)—even if continuous improvement and Japanese techniques of quality management really became popular only in the 1980s. The kinds of improvements carried out in western companies were aiming at reducing inventories and distribution costs, yet there also was a focus on reducing manufacturing lead times, suppliers lead times and safety stock. Exogenous factors—such as the skyrocketing fuel prices and interest rates as high as 20 %—also contributed to raising the management's attention towards efficiency of transportation and inventory management.
- *1980s*. The decade opened with the seminal paper by Peter Kraljic, published in *Harvard Business Review* in September 1983, in which the McKinsey director commanded that "Purchasing must become Supply Management"! (Kraljic 1983). Managers started following

Kraljic's exhortation, embarking on a process of integration (of logistics processes) with some (strategic) suppliers; at the same time, some companies reengineered supply chain cost structures in order to lower operating and capital expenditures, while others preferred a shift from cutting costs towards improving customer service.
- *1990s*. Finally, the shift from efficiency-driven to effectiveness-driven improvements was completed. Companies became aware of the need of rationalizing distribution channels, strengthening the relationship with existing channel partners, defining more rigorous distribution agreements and forming external partnerships—all this with the main goal to increase customer service. Another process that was finally completed in the 1990s was the transformation from dis-integrated logistics management all along the supply chain to integrated logistics—what we can now call supply chain management (Stevens 1989).

The turn of the century saw companies fully aware of the power of supply chain management. The supply chain is regarded as a tool to create value, not just save money. Supply chain management is a strategic driver of success in virtually any industrial sector, for a number of reasons:

- the firm is not a standalone entity but part of a network of interconnected firms;
- as a consequence, optimizing internal processes is no longer enough to remain competitive: companies need to manage processes going beyond the boundaries of the company;
- this created a shift of competition: from "company vs company" to "supply chain vs supply chain";
- the supply chain has then to be managed as a whole: this last argument demonstrates the relevance of supply chain management.

Effective management of supply chain activities and processes helps to reduce cost and improve customer service for companies. Additionally, it provides a new set of capabilities, which may help to increase revenues, improve profitability and create competitive advantage (Fig. 11.1).

In recent years, several important companies of the luxury industry have launched large reorganization projects aiming at restructuring their supply chains: these companies are devoting more and more efforts to

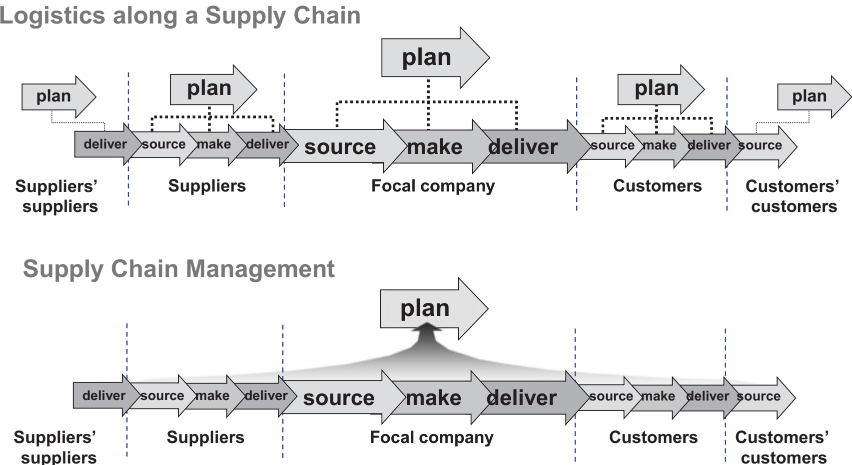


**Fig. 11.1** The shift from logistics along a supply chain to supply chain management (Adapted from Stevens 1989)

enhance their own and their partners' operations efficiency and to increase the alignment of the whole supply chain towards the CSFs for competing in their market. For sure, this can be considered the offspring of a process that is taking back managers from an exaggerated attention to brands towards reconsidering product- and distribution-related aspects (Gunasekaran et al. 2004).

One of the most noteworthy global trend characterizing luxury markets is that of always shorter product lifecycles and, as a result, commercial success or failure is largely determined by the organization's flexibility and responsiveness (Christopher et al. 2004). For the above reasons, researchers in the area of fashion started to focus their attention on the domain of supply chain management (SCM) (Harrison et al. 1999; Lowson et al. 1999; Christopher and Towill 2002; Bruce et al. 2004; Christopher et al. 2004). Indeed, the road towards competitiveness should go far beyond the management of a single company or even a supply chain, but passes through the management of the whole supply network ("today competes the supply chain, not the company", Christopher 2000) and sustainable competitive advantages through low cost or high differentiation can be achieved only by managing the interconnections among the various

organizations within a large network. At the same time, increased customer and market orientation is needed (Schnetzler et al. 2007).

The following Table summarizes the recent trends in the luxury business and the related challenges for supply chain management. As a consequence, the present chapter is dedicated to the basic principles of supply chain strategy and how a better alignment of the supply chain processes towards the CSFs would increase a luxury company competitiveness (Table 11.1).

**Table 11.1** Trends and challenges in luxury supply chain management

| Recent trends in the luxury business | SCM challenges |
|---|---|
| Success in recent years was based on building brand image and on extending product range: Loss of "material" competitive advantages Risk of diluting brand exclusivity into accessible lines | Back to basics—market orientation, product quality, service level, mastering core competences—to regain the ability to deliver up to the promises made by the brand. |
| Consumers are now more literate as regards quality in product/services and accept to pay a premium price when their requirements are satisfied | Guaranteeing adequate quality even though (part of) the production process is outsourced |
| Fashion effect: product lifecycle is everyday shorter | Flexible and responsive SCs |
| Rising attention to operations and SCM, with a number of companies currently restructuring their SCs (Prada, Bulgari, Versace, Ferragamo…) | SCM is now one of the top priorities in management's agenda, operations are more stressed |
| The soaring of scale and bargaining power of major retail buyers in the market, the advent of own brands retail networks, globalization of the luxury consumers | Attention to distribution and retail |
| Wide use of outsourcing of manufacturing processes; off-shoring of manufacturing activities and sourcing on a global scale | Need to control and coordinate a large and geographically scattered network of actors |
| New and aggressive players are now entering the market | Need to create a sustainable competitive advantage, leveraging the capability of all the "partners" within the supply network |
| Different requirements depending on the type of luxury (e.g., accessible lines require availability; exclusive segments require superior service) | Need to develop a differentiated approach |

# Typical Structure of the Inbound and Outbound Supply Chain

To be able to analyse the supply chain management strategy of companies in the luxury and fashion industry, it is important to briefly discuss the typical structure of both the "upstream" supply chain (how raw materials are flowing towards the manufacturing sites) and the "distribution channel" (how end products are distributed to the final consumer), with the standpoint of the "brand owner" (BO).

## Inbound Supply Chain

The typical structure of the inbound supply chain—as represented in Fig. 11.2—encompasses suppliers of raw materials, suppliers of components and finished goods, and sub-suppliers.

In comparison with other industries (such as the aerospace or the automotive), the idiosyncrasies of such a configuration are a sign of quite a naïve supply chain strategy, and—if not properly managed—could become a relevant issue threatening overall supply chain performances:

- High fragmentation of the production system, with a plethora of actors, each one taking care of a tiny part of the overall process.

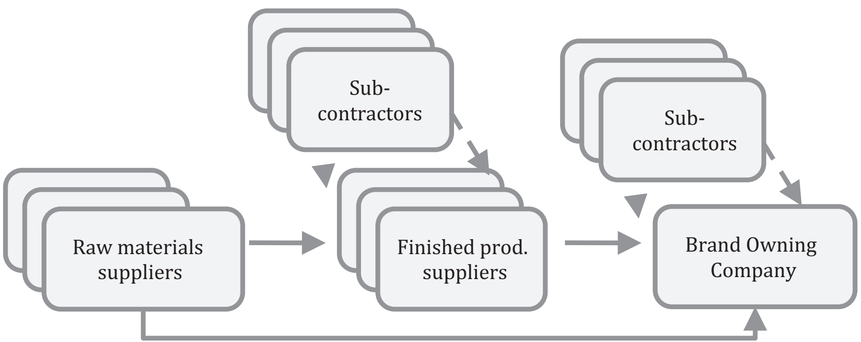


**Fig. 11.2** The typical structure of an inbound supply chain

- "Captive" relations with subcontractors—often working for the BO as their sole customer.
- Lack of formalized, written agreements, let alone long-term contracts.
- Outsourcing of some design activities to finished product suppliers—this is not an issue, provided that this practice is limited to extension lines and lower positioning products.
- Customized raw materials—this is a strength for higher-positioned, luxury products; yet, customized materials require proper and careful production planning and inventory management.

## Outbound Supply Chain (Distribution Channel)

The typical structure of the outbound supply chain, depicted in Fig. 11.3, encompasses the two noteworthy cases of directly operated stores (DOS) and independent trade (including a gamut of retail formats, from stand-alone shops to department stores).

Ownership and control of the trade, along with the duration of the product lifecycle are significantly influencing management choices in the outbound supply chain (in terms of IT tools, assortment planning, demand forecasting, approach towards replenishment, etc.).

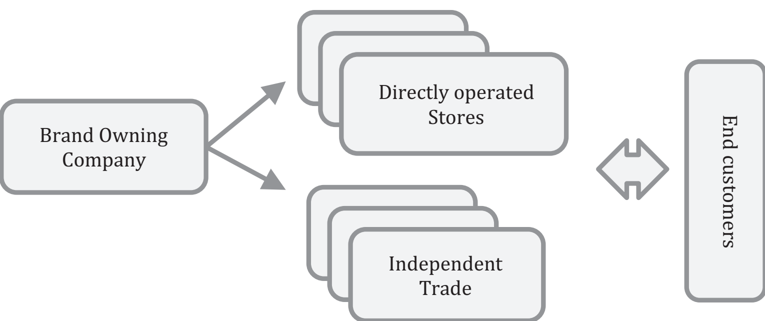


**Fig. 11.3** The typical structure of a distribution channel

## Typical Supply Chain Planning and Execution Processes

APICS defined a reference framework for supply chain planning and execution, which encompasses the following "core processes" (as depicted in Fig. 11.4):

- strategic business plan;
- sales and operations planning;
- master production scheduling;
- material requirements planning;
- suppliers scheduling and operative management;
- suppliers' performance management.

In the following, every phase will be defined and discussed in terms of inputs, outputs, planning horizon, planning period and updating frequency.

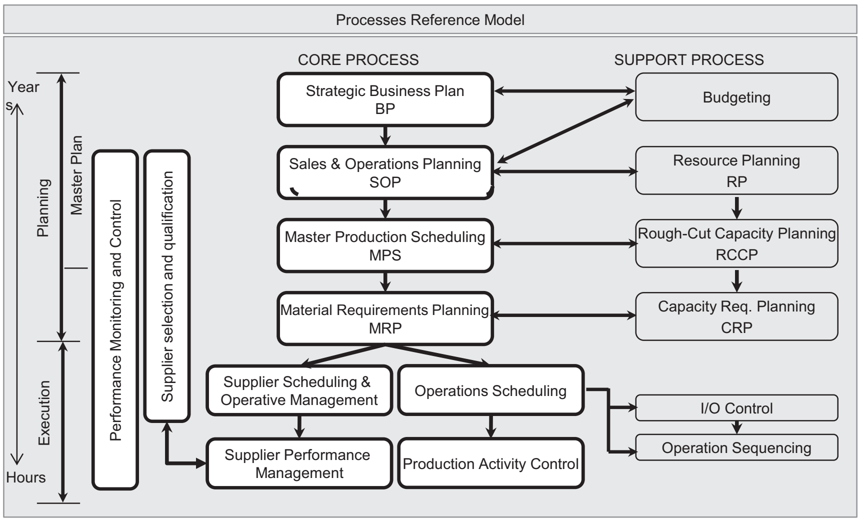


**Fig. 11.4** Core processes of the APICS framework

## Strategic Business Plan

The strategic business plan defines a set of actions to support the mission, goals and objectives of an organization. The strategic business plan generally includes an organization's explicit mission, goals and objectives and the specific actions needed to achieve those goals and objectives.

## Sales and Operations Planning

Sales and operations planning aims at developing tactical plans that provide management the ability to strategically direct its businesses to achieve competitive advantage on a continuous basis by integrating customer-focused marketing plans for new and existing products with the management of the supply chain. The process brings together all the plans for the business (sales, marketing, development, manufacturing, sourcing and financial) into one integrated set of plans. It is performed at least once a month and is reviewed by management at an aggregate (product family) level. The process must reconcile all supply, demand and new-product plans at both the detail and aggregate levels and tie to the business plan. It is the definitive statement of the company's plans for the near to intermediate term, covering a horizon sufficient to plan for resources and to support the annual business planning process. Executed properly, the sales and operation planning process links the strategic plans for the business with its execution and performance measurements for continuous improvement.

Main inputs of the sales and operational planning processes are:

- target *turnover*;
- balance among *cost*, *quality*, and *service level* targets.

At this stage it is still possible to modify the configuration of the production system, expanding or reducing the production capacity, and changing the approach to demand fulfilment (e.g., according to the so called make-to-order (MTO) or make-to-stock (MTS) policies).

From the "operations" side main output of this phase is a plan indicating—albeit in a rough or aggregated way—how much to produce, in every period, of every product type, in which production sites and with which resources.

In terms of level of aggregation and planning horizon, the sales and operational planning phase operates as follows:

- Demand is aggregated by "commercial families" (products with similar demand characteristics, which could be different from a technological point of view).
- *Production capacity* is considered in the most aggregate way, using as elementary unit the capacity of every plant (units/year).
- Sales and operational planning's *planning horizon* could span over several years (in general, from two to five, depending on the products' specificity).
- It is typically split into *planning periods* of one year or one season (six months).
- It is *updated* every 6–12 months (or upon request).

Sales and operational planning aims at configuring and rightsizing the production system. Degrees of freedom at this stage are:

- strategic make or buy decisions;
- production capacity modifications;
- product and process redesign (with a manufacturing perspective);
- investments in automation;
- supply chain redesign;
- approach to demand fulfilment (MTO vs MTS) and volumes production (one-off vs batch production).

## Master Production Scheduling

Master production scheduling receives, as constraints, the decisions made during the sales and operational planning. A production plan (master schedule) is then determined, defining exactly how much to produce for every product family, in every period.

Inputs for this stage are:

- *order portfolio* and *demand forecasts*;
- available *production capacity*, with a detail by resource type;
- on-hand *inventory*;
- *specific goals* such as service level (for MTS productions, such as spare parts) and work in progress.

The output of this stage is a production plan called master production schedule (MPS), where production volumes are deployed by product and period.

Relevant characteristics in terms of level of aggregation and planning horizon of the MPS phase are as follows:

- In terms of *products*, demand is typically aggregated by "technological families" (i.e., products similar from a technological point of view, requiring similar resources both in terms of types and quantities, are typically grouped together).
- In terms of *production capacity*: the plan refers to single departments/lines.
- *Planning horizon* is typically around one or a few years.
- While the *Planning period* is typically in the range of one week to one month.
- The MPS could be updated as frequently as once a month.

Degrees of freedom in the MPS stage are the following:

- First of all, minor changes in production capacity are allowed. They typically refer to overtime, although hiring/firing might be considered in certain cases.
- At the aggregate planning level, decisions concerning short term make or buy (i.e., outsourcing some of the capacity to sub-suppliers), batch size, rearranging priorities between products/customers and production orders postponement/anticipation could be made.
- Finally, minor adjustments in the manufacturing system configuration are still allowed. Such adjustments could regard manpower organization

(e.g., training, reorganizing shifts, etc.) or process streamlining (with minor re-layouts, introduction of parts supermarket, kitting, etc.).

## Materials Requirements Planning

Once the MPS has been determined, it is necessary to generate production orders (for activities carried out at internal production departments and sites) and purchase orders (products and components sourced from external suppliers) in order to guarantee materials and component availability as required by MPS.

Main inputs of the production and purchase orders generation phase are:

- The *MPS* (at this stage, in case of custom products, the exact sequence of products in the final assembly line should be determined).
- *Technical information* (such as the bill of materials and production cycles).
- *Management information* (such as on-hand inventory, supply and manufacturing lead times, and so on).
- Already launched *production* and *purchase orders*.
- *Inventory* or ordered parts already *booked* for other productions.

Relevant characteristics of production and purchase orders generation phase are as follows:

- In terms of *products*, demand is exploded to the maximum detail (end product are not grouped in families but if available, exact bill of materials of every end product is utilized).
- While the production capacity is often not taken into account at this stage.
- The *Planning horizon*: depends on production/purchasing lead time (up to 12 months).
- *Planning period*: this is typically around one week (might go down to one day, which makes sense only if real-time data on production advancement are available).
- *Updating frequency*: weekly.

## Supplier Scheduling and Operative Management/ Operations Scheduling

By looking at the APICS reference framework depicted in Fig. 10.4, it could be noted that from mutually recognized product (MRP) procedure derives two parallel processes. For production orders (i.e., related to materials or components to be produced internally), the operations management team is in charge of operations scheduling, while for purchasing orders (i.e., related to "buy" components or materials), the purchasing department takes care of supplier scheduling and operative management.

When "scheduling" suppliers, the purchasing department provides suppliers with schedules rather than with individual purchase orders. A supplier-scheduling system typically includes a general agreement (contract) and a schedule extending into the future and updated with an agreed upon frequency (e.g., weekly).

No matter whether it focuses on internal production facilities or on what is going on at a supplier's site, scheduling is in charge of defining the allocation of production/purchasing orders to available production resources.

Main inputs of this phase are:

- already released production orders;
- up-to-date information regarding the availability of both direct production resources and indirect production resources (such as toolings, quality control laboratory, handling devices, spaces, etc.);
- information regarding strikes, absenteeism, machinery breakdowns, maintenance operations and any other factors affecting actual production capacity;
- real-time information on production advancement;
- changes in customer requests or other external factors (such as the rescheduling of a delivery date).

Relevant characteristics of the scheduling phase:

- A production schedule is a plan with the highest detail both in terms of *products* (single part number and single processing phase) and *production capacity* (maximum precision, down to the current state of each single machine or work centre).

– For this reason, the *planning horizon* of the scheduling phase seldom exceeds one (or a few) week(s).
– The *Planning period*, depending on the way data are gathered from production, could be ranging from one day to fraction of a shift.
– Depending on availability of real-time information and frequency of plan disruptions, the schedule could be *updated* up to several times in the same day (however, at least once a week).

Degrees of freedom of Scheduling phase concern:

– the logic of Production orders review and release;
– the dispatching and routing of production orders;
– the sequencing of production orders on each single machine;
– the possibility of pre-emption (stopping a production order after processing has started);
– work-force reorganization; and
– finally, the rescheduling of planned maintenance activities.

## Supplier Performance Management/Production Activities Control

As already mentioned for the scheduling process, here also we have two different processes—namely, production activities control and supplier performance management—depending on whether we are considering "make" or "buy" components. The effectiveness of both phases is heavily depending on the definition of key performance indicators (KPIs) to measure and assess suppliers' performances (defining appropriate scorecards—typically focusing on such performances as delivery reliability, lead time, quality and price—and implementing a process referred to as vendor rating) and on the way the trend of said KPIs is shared with suppliers (e.g., employing web-based tools).

Production activities control and supplier performance management are control phases finally closing the planning and control process, by monitoring actual production and reporting to the planning system significant departures from plans.

This phase is very simple from a logical point of view. Yet sometimes it could be very complex to implement. When possible, automating the data collection process would make things easier (operators often claim to be "too busy" to report beginning/end of production in real time). In any case, paperless data collection (through bar-code readers or touch screens rather than check sheets) will avoid typical problems (such as operators overload, delay in inputting data, clerical errors, etc.) associated with paperwork.

Relevant characteristics of Supplier Performance Management and Production Activities Control phases are as follows:

- In terms of *products aggregation level*, as for scheduling, the control is carried out with the maximum detail: single part number and single processing phase.
- *Planning horizon* and *planning period* are not relevant, as performance management and production control are carried out ex post.
- Finally, the *updating frequency* is real-time, whenever it is required to give timely feedback to other planning phases. Otherwise, end-of-period (like, for instance, monthly) reporting would be enough for performance evaluation.

## Noteworthy Examples of Supply Chain Configurations

D'Arpizio (2007) identifies three classes for luxury goods, observing that different performances are achieved in different markets. The same three categories are consolidated by the fashion and luxury insight of Bain & Altagamma (Altagamma 2008):

- *Absolute luxury products*, characterized by elitism, heritage and uniqueness (e.g., Harry Winston, Bottega Veneta, Brioni and Ferrari). These products constitute the luxury goods segment that traditionally drove the market and indeed is still strong in one of the most important markets, Japan.

- *Aspirational luxury products*, which are recognizable and/or distinctive, and represented by such brands as Gucci and Louis Vuitton, and BMW for cars. In the past 20 years, these represented the largest rate of luxury goods growth in the USA. Forecasts for the future are suggesting a possible inversion in the trend, though.
- *Accessible luxury products*, characterized by affordability, status and membership, and represented by such brands as Michael Kors and Furla, as well as most fragrances. In recent years this category has achieved a huge growth rate in Asia-Pacific (excluding Japan)—nearly 2.5 times greater than the global average for "accessible luxury" sales growth. This leads to the conclusion that sales growth in Asia-Pacific is driven by high degree of entry-level access to luxury goods.

As suggested by an in depth analysis of the literature, beyond the three types of luxury listed above, also the category of mass-market goods should be included when dealing with the fashion business. For instance, Fernie et al. (1997) observe that most of the companies operating in the fashion luxury business manufacture and sell, beside their exclusive "haute couture" products, one or more "diffusion lines": these are relatively low priced and available in fairly large volumes, in order to reach a wider consumer segment and introduce them to the brand's lifestyle.

A year-long research project involving several Italian brands (Brun et al. 2008; Caniato et al. 2009; Castelli and Brun 2010) discusses whether the supply chain configuration and the supply chain management strategy depend on factors such as the type of product and the level of positioning of the brand (accessible-aspirational-absolute). As a consequence, there is no such thing as "the typical luxury supply chain". To give a better idea of the possible alternative configurations of specific luxury fashion supply chains, in the following, three cases excerpted from Brun and Castelli (2008) are presented. Albeit being constituted by all mid-size, Italian companies, the sample is quite differentiated in terms of product categories they produce and distribute (shoes, leather bags and accessories, swimwear and underwear) and different positioning of their brands (ranging from aspirational luxury to diffusion lines). This will allow a better comprehension of different supply chain configuration and management strategies.

A general summary of the three cases is given in the Table 11.2 and the details are given in the following subsections.

**Table 11.2** Synoptic table of the three noteworthy examples (excerpted from Brun and Castelli 2008)

| | Fratelli Rossetti | Bric's | Parah |
|---|---|---|---|
| *Core business* | Luxury shoes | Bags and suitcases | Swimwear and underwear |
| *Product categories* | Formal men's shoes<br>Formal women's shoes<br>Sports shoes<br>Accessories | Suitcases<br>Office bags<br>Handbags<br>Accessories | Swimwear<br>Underwear<br>Concept wear<br>Accessories |
| *Brands positioning and personality* | *Fratelli Rossetti* (company owned): luxury brand. Excellent quality, heritage of craftsmanship, made in Italy | *Bric's* (company owned): high positioning brand. Innovation, design, high quality | *Parah* (company owned): luxury brand. Excellent quality, characterizing design, innovation, made in Italy |
| | *Flexa* (company owned): diffusion brand. Sport, good quality, quality/price | *Kipling* (licence for distribution only): diffusion brand. Sport, young | *Off Limits* (company owned): diffusion brand. Basic design, good quality, quality/price |
| *Retail channels* | Direct operated mono-brand stores (DOS) | Direct operated mono-brand stores (DOS) | Direct operated mono-brand stores (DOS) |
| | Franchising mono-brand stores | Specialist independent retailers | Franchising mono-brand stores |
| | Specialist independent retailers | Department stores | Specialist independent retailers |
| | Department stores (corners) | Factory outlets | Department stores (corners) |
| | Factory outlets | Airport lounges | Factory outlets<br>Airport lounges |

## Calzaturificio Fratelli Rossetti

The "Calzaturificio Fratelli Rossetti SpA", with a turnover of €78 million in 2012 and a year-on-year growth of about 10 % in recent years, is a luxury shoes manufacturer, worldwide famous for the excellent quality of its products. This has allowed to the company to achieve a very high brand reputation. Such reputation is mainly due to the heritage of craftsmanship as regards the company's core product: high-quality formal men shoes. The company, whose headquarters are located in one of the most renowned

Italian shoe districts, started its activity at the beginning of the twentieth century and, over the years, expanded its competences from bare shoes manufacturing to product design both in terms of functionality and style, so incorporating the current trends, which require constant style updates.

Men's shoes were initially sold under the company name brand (Fratelli Rossetti): women's shoes were added later, in order to complete the product range. In contrast to a common misbelief, the manufacturing process for high quality shoes not only includes many handmade stages but is also extremely complex, involving several phases and a number of time constraints (e.g., 24 hours are needed to properly dry the glue to fix the two main subassemblies of the shoe). Furthermore, the process is significantly different for men's and women's shoes, not only because of physiological differences in the shape of the feet but also due to differences in component type and in the variety of styles.

Such structural differences in the product are the reason why, while the process for manufacturing men's shoes is performed solely in the company facilities in the original Italian district (with few exceptions for special refining phases required by particular items), the company decided to outsource the manufacturing process for women's shoes to specialist manufacturers in the same district. Hence, the company—as regards women shoes—manages internally the design phase, the distribution process and the material selection process, while outsourcing all the manufacturing phases as well as the product development and engineering. Outsourcers are selected on the base of product quality and service level (mainly delivery lead times) and are therefore located within the district, also in order to allow the use of the "made in Italy" label.

Lately, the company also introduced the brand Flexa with the aim of diffusion, that is, inviting new consumer segments to approach the company's offer. With Flexa, the company offer expanded to a new product category, namely sports shoes. As these products are meant to offer a good quality/price balance while—given the lower brand positioning—the "made in Italy" label is not required. The company therefore decided to design the products in house while delocalizing all the manufacturing phases to outsourcers in Eastern Europe.

The company's products are sold through a variety of retail channels. Some differences can be observed in the product mix available to the different channels.

- *DOS mono-brand stores* have a precise style characterization, in terms of store design, furniture, colours and service standards. The store personnel are directly employed by the company and required to attend a training course in order to correctly communicate the company and brand images. These stores have access to the whole product range, and the merchandise mix available in each store is centrally decided by the company's marketing department. These stores also benefit from direct contact with the company (through a shared information system) and the possibility of replenishment with short lead times (often the company manufactures MTO products to deliver to these stores). Thanks to the shared information system, the company can access sales data, thus getting a better insight on the current demand and an input for the forecasting process.
- *Franchising stores* present the same store design, style and image characterization as DOS stores; in contrast the personnel are not directly employed by the company and therefore not necessarily trained to communicate the brand. These stores can also access the whole product range, but they mainly interact with the company through placing one order per season; sometimes exceptions (e.g., buyback or transhipment between stores under special conditions) can be allowed. Corners in department stores and in airport lounges are managed in the same way as franchised stores.
- *Independent specialist stores* do not have to follow strict requirements in terms of store design, but are selected by the company on the basis of the range of carried brands. They have access only to a part of the company product collection and must place orders exclusively during the selling campaign. Their relationship with the company is intermediated by agents. The company applies a MTS manufacturing strategy for products destined both for franchises and independent stores.
- *Factory outlets* are owned by the company and are mainly regarded as a way to minimize the losses due to unsold products.

The company also designs and distributes leather accessories (bags, wallets, key-rings), but—as they are not regarded as core products—their production is completely outsourced to specialist companies. Moreover, due to the range completion purpose of such accessories, they are exclusively sold in the mono-brand DOS and franchising stores.

The resulting supply chain configuration is depicted in Fig. 11.5.

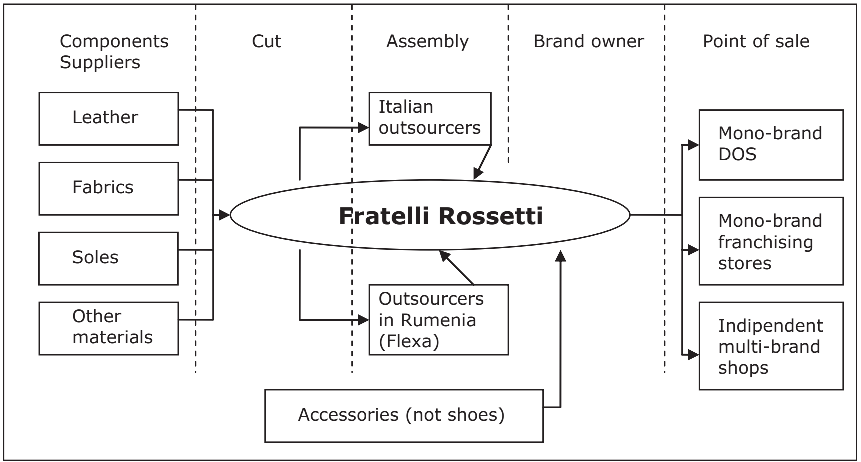


**Fig. 11.5** Fratelli Rossetti supply chain configuration

## Bric's Industria Valigeria Fine

"Bric's Industria Valigeria Fine SpA" (whose turnover at the time of the study was about €40 million) is an Italian manufacturer of high-quality travel suitcases, handbags, office bags and accessories (such as wallets, key rings and small leather cases). The initial business, which dates back to the mid of the twentieth century, was focused on leather travel suitcases and office bags, which were mainly sold locally (in northern and central Italy). The high quality of the products (which derived mainly from high quality leather sourced in Italy and from exceptional craftsmanship capabilities) soon led to growing demand, not only from local customers. Soon the company evolved from a small family-run business to an international player in the fashion market.

Other product types were added to their offerings besides travel items: the natural product line extension was towards women's handbags, which could easily be manufactured in the existing production facilities. However, the introduction of such products required the company to achieve a good level of understanding of product design, not only

in terms of manufacturing and material requirements but also in terms of style issues. Further development in terms of products cam with the introduction of materials different than leather, for instance fabric and polymeric materials. Such new materials, on the one hand, required new manufacturing competences and, on the other hand, proved much less expensive than genuine leather.

At the same time the company realized that the physical characteristics of their products were no longer enough to compete on the fashion market and understood the need for establishing a proper fashion brand. Thus, a strong marketing effort was put on the creation of a set of positive fashion associations to the company name, that is, brand values. From that moment on, the stage of product design had to take explicitly into account the need of creating brand-consistent collections.

As demand and product variety increased, the company differentiated the manufacturing process for different items: the decision was to keep in house the whole manufacturing process for high quality leather goods and suitcases with high material technology contents, while production of low-priced lines (low-cost materials, sold at relatively low prices on the consumer market in order to attract young fashion-sensitive people) was outsourced to companies in the Far East.

Bric's has a large network of suppliers and outsourcers. Most of them work on the basis of spot orders or annual contract. Thanks to a long-term relationship, some high-quality specialist outsourcers allowed the introduction of collaborative supply programmes. However, there is no IT-supported information exchange with them, as their small size doesn't allow significant IT investments.

The main retail channel for the company's products has always been that of independent specialist retailers, some of which the company was able to build a strong long-term relationship with. A relevant achievement, with respect to these partners, was the introduction of a shared information system: each retailer communicates periodically (some of them daily) its sales to Bric's, which, in turn, provides updated information about its inventory status. The orders from retailers participating in the system typically have priority compared to orders from less loyal retailers.

Recently the company expanded its direct activity into retail, by opening a network of DOS. These are mainly flagship stores through which the company is supporting its expansion into foreign markets: indeed, flagship stores have a strong brand establishment purpose. As these stores are directly operated, their access to the information system is enhanced compared to independent retailers. Sales data and inventories are visible in real time, so that demand trend can be anticipated and replenishment of specific items can be centrally planned by the company.

Thanks to information sharing with DOS and selected retailers, Bric's was able to replace, for some product families, the original MTS policy with a MTO one.

At the beginning of the 1990s, the company also acquired a licence for exclusive distribution in the Italian market for the brand Kipling.

The resulting supply chain configuration is depicted in Fig. 11.6.

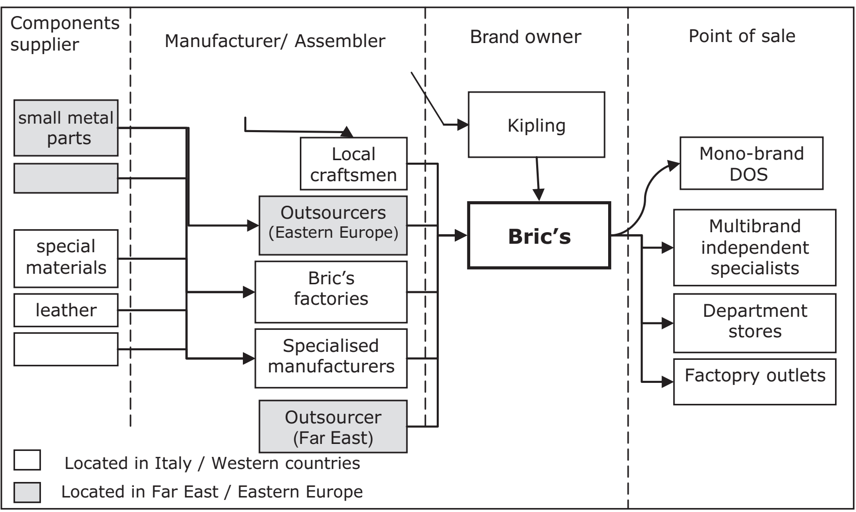


Fig. 11.6 Bric's supply chain configuration

## Parah

Gruppo Parah SpA, with more than €30 million turnover and about 170 employees, is one of the top ten world manufacturers of fashion lingerie and swimwear. The company was established at the beginning of the twentieth century as an artisan shop of high quality lingerie. The founder, an Italian lady with a strong interest in fashion, identified the need for creating women's lingerie products that are both comfortable and extremely stylish. The natural product extension was in the business of swimwear: these items were introduced as soon as the activity shifted from an artisan shop to an industrial company. A third product category was recently introduced, that is, concept wear, an apparel line characterized by comfortable fabrics, casual purpose and fashion design.

The exclusive positioning in the luxury niche in the market was seen as a limitation for demand growth. Hence, beside the original luxury lines for which the company brand (Parah) was renowned, diffusion lines were introduced under a different brand (Off Limits).

As time went by, the company realized that it was worth deciding which competences to keep in house and which instead could be delegated to outsourcers. Nowadays the company keeps solely in house the processes of product design and new product development: indeed, product innovation (both in terms of style and functionality) is one of the CSFs targeted by the company. Furthermore, the company keeps in-house the fabrics cutting phase for the luxury lines, while the assembly phase is outsourced to local manufacturers, in order to enable the use of "made in Italy" labels. In contrast, the whole manufacturing process is outsourced to the Far East for the diffusion lines. As regards accessories (such as perfumes, scarves, gloves and, small bags) both design and production are completely outsourced to specialized Italian companies.

All the products are stored in the company warehouse where statistical quality controls take place; then appropriate branded packaging is applied to every item and a delivery box is prepared specifically for each store.

The company's products are sold worldwide through 52 mono-brand stores (accounting for 10 % of the total sales; 85 % of them are directly

operated), independent specialist retailers, department stores and a company-owned factory outlet.

- *DOS mono-brand stores* have a precise style characterization, in terms of store design, furniture, colours and service standards. The store personnel are directly employed by the company and is required to attend a training course in order to correctly communicate the company and brand image.
- *Franchising stores* present the same store design, style and image characterization as DOS stores; in contrast the personnel are independent from the company and therefore not necessarily trained to communicate the brand. Both DOS and franchised mono-brand stores have access to the whole product range and communicate sales data to the company via a shared information system.
- In contrast, *department stores* and *specialist stores* sell only the diffusion lines, with the exception of some selected retailers located in downtown areas of the international fashion capitals (such as Milan, Paris, New York, etc.), which can also access the luxury lines.
- *Factory outlets* are owned by the company and are mainly regarded as a way to minimize the losses due to unsold products.

The resulting supply chain configuration is depicted in Fig. 11.7.

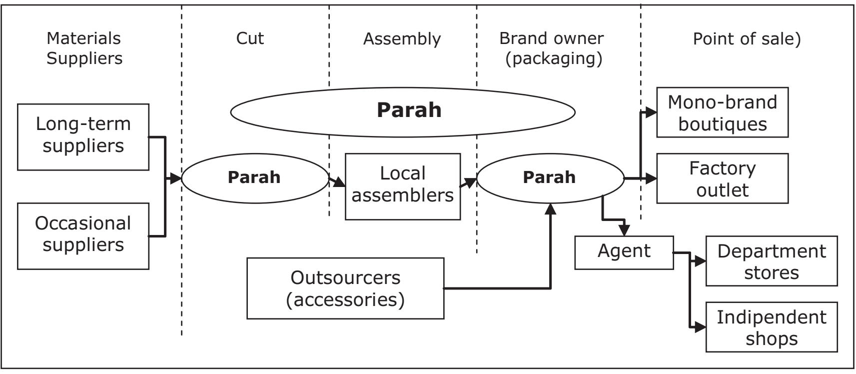


**Fig. 11.7** Parah supply chain configuration

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# 12

# Creating a Seamless Experience for Luxury Consumers Integrating Online and Offline Communication

Fabrizio Maria Pini and Valeria Pelleschi

For a long time, luxury companies regarded digital channels and media as incompatible with the kind of experience they intended to offer their customers (Heine and Berghaus 2014). This lack of interest was strongly related to the assumption that digital marketing was aimed at mass consumption, while luxury consumers favoured a personal touch in their purchases, along with the rich and stimulating experience offered by high-street boutiques and mono-brand stores (Dell'Olmo et al. 2003). In more general terms, e-commerce sites, search engines and social media were perceived as playing with a set of rules at odds with what luxury brands stand for: rich symbolic engagement for a small social elite eager

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to experience a multisensory exposure to the brand and its products. In an effort to meet the expectations of high net worth segments, luxury brand strategies were characterized by top-down approaches and social prescription (Kapferer and Bastien 2009). For example, brands such as Chanel or Louis Vuitton originally established their identity and brand awareness through a small community of fans within the showbiz or fashion industries. Back when luxury was supposed to be the preserve of the social elite, this goal was typically accomplished through face-to-face interaction and personalized care. This approach to value creation generated a natural distrust of all crowdsourcing and co-creative practices—the backbone of digital media jargon—among luxury companies.

Only in recent years have luxury brands approached digital channels from a different perspective and grasped the opportunities offered by the new touchpoints for enriching customer experiences and supporting rich and complex brand narratives. According to recent surveys by McKinsey (Dauriz et al. 2014), e-commerce still accounts for a mere 4 % of luxury sales, but this is only one aspect of the different opportunities offered by a multichannel approach. There are many ways through which digital channels can influence luxury consumer behaviour, and the stage of purchase might not be the most significant one. Online search activity, as well as engagement with social media contents and participation in online groups and communities affect consumers' perception and motivation towards brands and products and may eventually lead to an offline purchase. The ubiquitous presence of mobile devices such as smartphones and tablets allows customers to interact with digital contents even while shopping in physical retail stores, creating a completely new way of influencing or driving purchases in brick and mortar outlets. Therefore, the integration of online and offline touchpoints plays an increasingly significant role in the consumer's shopping and purchasing experience, dramatically reshaping the way luxury companies and their brands can create value for their customers.

The number of touchpoints itself has grown dramatically in the past few years through the adoption of a whole array of new digital devices and interfaces that allow customers to engage with the brand in multiple contexts and in a variety of interactions. A recent survey conducted by Digital LBI in 14 countries (2014) highlighted that 88 % of smartphone

users research products online before buying offline, while 72 % of them look up information on their mobile devices while shopping in-store. Luxury consumers are changing their media consumption patterns, too: spending more time searching for products online and being influenced by recommendations and ratings posted by peers on social media. The combined use of online and offline touchpoints is highlighted by the results of recent surveys: "Google-mobile in search" (2014) revealed how more than 40 % of customers use their smartphones to make price comparisons while purchasing clothes and accessories. On the other hand, the relationship between the brand and its consumers is progressively evolving into a co-creation paradigm in which customers participate—in various forms and with different levels of engagement—in the creation of the brand value proposition and of the product value that is being offered to them (Bettencourt 1997; Prahalad and Rangaswamy 2001; Hamel 2002; Bendapudi and Leone 2003; Mooney and Rollins 2008; Pini 2009, 2010). Concepts such as social shopping are rapidly becoming the jargon of many marketing departments in the luxury industry: a pioneer in this field was Burberry with its campaign "The Art of the Trench" dating back to 2009–2010. The campaign focused on the creation of a website where customers could upload and share pictures taken while wearing a Burberry trench coat, an iconic product of the British brand. In order to guarantee a tighter control over contents and interactions, a standalone website was chosen over other social media platforms such as Facebook. Influencers such as Scott Schuman, also known as The Sartorialist after his street style fashion blog, were involved in the promotion of the initiative. Visitors to the website were offered the opportunity to upload their own photos or simply browse, share or comment existing ones, sorting them by gender or popularity; finally, they could choose to head to the Burberry e-commerce website for purchases. The campaign was remarkably successful in many ways: from the Facebook fan-base boost of almost one million, to the 50 % increase in sales through the e-commerce channel.

Despite the ever growing interest in digital media communication among luxury companies, the need for a real integration of online and offline interactions in creating and delivering a unique seamless customer experience is still weak, and many marketers still prefer to separate advertising, retail and digital experiences and manage them separately.

Even though this approach allows for an easy allocation of resources and responsibilities within the marketing department and among different functions and channels (e-commerce and bricks and mortar points of purchase are very seldom perceived as part of a unique process of interaction with consumers), it dangerously underestimates the real behaviour of customers, who naturally surf from a digital touchpoint to a physical one, and inhibits any chance of delivering differentiating experiences throughout customer journeys (Venkatesan et al. 2007).

The purpose of this chapter is to offer a comprehensive overview of the major changes introduced by both digitalization and an active stance from consumers in the customer experience of luxury products and brands, and to offer a set of models and tools allowing managers to design and manage rich branded interactions across different touchpoints.

## Seamless Customer Experience in the Luxury Purchase Process

In luxury sectors, the purchase and consumption processes are driven by self-representation and social storytelling, both supported by a rich narrative flow involving the luxury brand, its distributors and stakeholders, and the final customer. In this context, brands should create a prestigious universe and memorable experiences as the backbone of their value creation process (Atwal and Williams 2009). Over the last few years, many studies have explored the concept of customer experience, both in theory and in practice. Customer experience can be defined as a set of interactions between the customer and the brand through the different elements that represent the latter—such as the sales force, products and services, store layout and merchandising, social media pages, website pages, apps, etc.—generating a reaction of functional, cognitive or emotional nature (LaSalle and Britton 2003; Shaw and Ivens 2005). In this sense, experience is strictly personal and implies the involvement of the customer at different levels: rational, emotional, sensory, physical and spiritual (Schmitt 1999). Customer experience can be depicted as a flow of interactions occurring between the consumer and the brand's different touchpoints over a certain period of time: to provide a satisfactory user experience, luxury companies

should then ensure brand consistency and value proposition through different touchpoints (Basini 2001). This calls for a holistic approach to the topic implying the design of a rich and integrated set of interactions throughout the customer journey with the brand. Establishing strong and meaningful relationships between brand and consumers throughout the customer journey requires actions at three different levels:

(i) *Content design*: the nature and quality of the contents provided to customers through different stages of their customer journey and different kinds of touchpoints. Contents should both support the brand narrative and allow customers to perform their tasks easily.
(ii) *Context design*: the way a luxury brand delivers information, entertainment, services, products, etc. during the journey. Contexts define the way in which customers access contents at different stages of the journey.
(iii) *Infrastructure design*: the mix of channels, digital and physical, behind an effective customer experience. This mix should be regarded as a single system, supporting the delivery of a "seamless" experience in which customers do not perceive or feel any disruption in the experience flow when shifting from one touchpoint to another.

In this regard, the brand narrative process should be designed having in mind the nature of the touchpoints, customers' goals and motivations at different stages of their journey, and the nature of the context in which the interactions take place, in order to provide the proper set of contents enabling the branded experience (Boaretto et al. 2011).

The core tenet in the evaluation of customer experience quality is the comparison between customers' expectations and the stimuli coming from the interactions between brand and user in different touchpoints throughout the customer journey. Many research studies have shown the importance of experience as an antecedent to satisfaction and loyalty (Oliver 1997; Reicheld 1996). Moreover, the model proposed by Gentile et al. (2007) presents experience as the main interaction or interface space between the customer and the company and connects it to the notion of value creation for both sides. On the one hand, customers are expecting and perceiving value from the brand; on the other hand, the company is

both offering and seeking value from customers. Value creation from the company's perspective can be measured by such indicators as sales, market share, brand equity or customer equity (Ferraresi and Schmitt 2006). Customers, on the other hand, receive value on a utilitarian or hedonic level (Holbrook 1999; Addis and Holbrook 2001).

Among the most promising touchpoints for delivering rich branded experiences, the mobile channel offers great opportunities for interaction with customers, increasing the quality of their experience with the brand, merging physical and virtual reality in a single interaction and, at the same time, capturing real-time data. Augmented reality mobile apps may allow luxury brands to provide engaging 360-degree product experiences to customers long before they show up in-store. Try-on apps give customers the chance to experiment with jewellery and other luxury goods and share their experience with their peers through social media connections. Augmented reality allows for radical changes to the physical touchpoint, too. By adding layers of virtual content to a physical environment, these apps can customize the shopping experience and turn a boutique's common space into a personalized one containing information and suggestions based on customers' tastes and previous experiences with the brand.

## Supporting the Luxury Purchase Process in a Multichannel Environment Through Transmedia Storytelling

Luxury companies opting for a multichannel approach to their communication and distribution strategies need to address the challenges posed by the creation of a multi-sensory "experience of luxury" on digital supports and platforms. The physical experience of a luxury store is designed to magnify product aesthetics and provide customers with a huge array of multi-sensory stimuli, in order to appeal to their emotions and facilitate the learning process of values and narratives expressed by the brand. On the contrary, digital touchpoints might be unable to convey the look and feel of sophisticated luxury materials and the extraordinary attention to detail typically found in luxury goods. Showcasing luxury in digital environments presents some unique challenges. If luxury brands do not

establish their presence in the digital landscape for reasons of desirability and exclusivity, then they will risk losing contact with their customer base and potential new clients. On the other hand, overexposure may tarnish the shine that made them special in the first place. That is the fine line walked by brand managers when trying to maintain a balance between the perception of brand exclusivity and accessibility. In this sense, combining the traditional luxury brand image with the use of innovative technologies is of the utmost importance (Hennings et al. 2013) in order to achieve key marketing goals such as (i) top of mind awareness, (ii) two-way communication flow with consumers and (iii) engagement of influencers and communities in supporting brand narratives (Kapferer and Bastien 2009; Atwal and Williams 2009). Brand awareness plays a crucial role in luxury markets: awareness building and strategic role show some very unique traits compared to mass markets; indeed, according to Langer and Heil (2015), the role of awareness in luxury and non-luxury goods marketing is diametrically different. Luxury brands typically require generating additional awareness among potential non-users on a similar social level as the potential purchaser: in fact, only widespread awareness among those serving as a reference point for the consumer's conscious or subconscious desire of social separation and selectivity will enable luxury brands to effectively deliver additional luxury value. Moreover, brand awareness plays a dual role for luxury brands, keeping the "dream" alive in the minds of consumers long before supporting sales. Luxury brands should be guided by this perspective in their approach to digital channels and social media, and use them not only to create awareness but also to maintain brand engagement, allowing users to be part of the brand's world and experience it. When it comes to conquering top of mind awareness, competition is not only about storytelling but also about transmedia storytelling, entertainment and engagement. Luxury consumers are in a position to choose the kind of content they wish to consume, timing of consumption and what kind of device they want to use; this forces brands to meet the audience in any context and with multiple formats and contents (Bernardo 2014).

Approaches to transmedia storytelling can be clustered into three different categories, depending on the predominance of one specific media or the story itself. The most established form of transmedia storytelling

involves a core content that is promoted through complimentary contents across multiple platforms: a hi-end or luxury brand's catwalk show is an example of such an approach to storytelling when its content is promoted on digital platforms broadcasting "samples" of the central experience and driving interest to it. In this integrated media approach, priority is on the core product, while contents available on the other platforms serve as gateways. One of the critical aspects of this kind of approach is the ability to guarantee a consistent experience across different channels and platforms. When accessing catwalk content on a smartphone, customers expect the same level of quality and the same emotional connection they might have if they were in the audience.

The second approach is based on the creation of multiple initiatives on different platforms: assuming that some of them might gain relevance and go viral, they are managed separately. Contents are individually created and then promoted through digital media; if the specific product is successful, the brand might envision converting it into transmedia content and developing it extensively. This approach was very common during the first wave of digitalization in luxury companies: adopting a "wait and see" stance, separated and unconnected digital products were created in the hope that some of them would grab users' attention. Clear evidence of this approach is available in many "App stores", where brand-related digital products sharing no common traits nor has a brand or experiential thread piled up over time: from virtual stores, to digital catalogues or collection-related apps, down to travel guides and configurators.

The last approach falls under the definition of "organic transmedia" as "platform agnostic storytelling" devised by Bernardo (2014) or the one provided by Jenkins et al. (2006): "A transmedia story unfolds across multiple media platforms with each new text making a distinctive and valuable contribution to the whole." Although each component can be experienced individually, they all clearly exist in relation to each other in the larger transmedia story. A story intended to be told across multiple media types, or crafted with later expansion in mind, will often be woven with a notably different mindset from one that's originally intended to be a self-contained independent narrative. "Consumers become hunters and gatherers moving back across the various narratives trying to stitch together a coherent picture from the dispersed information" (Jenkins et al. 2006). This

latter approach to storytelling through the integration of different media is the one that better fits the communication purposes of luxury brands, allowing them to deliver a culturally complex message through different touchpoints—each reinforcing the overall brand experience.[1]

Transmedia storytelling calls for the creation of a unified content platform for the brand, which is able to deliver contents on different channels and through different supports, while retaining the coherence of messages and the quality of the overall experience for customers. This platform should be designed as an open system, capable of accepting and enhancing user-generated contents and co-creative activities from customers, third parties and influencers. This approach to storytelling requires a strict attention to timing, in order to guarantee brand "ownership" of all the pieces of news and contents that may be related to it, its products and services, and the topics that define the brand's content strategy. Transmedia approach to different channels and media takes into account their uniqueness and characteristics in order to decline their contents accordingly. For the purpose of this chapter, these touchpoints can be divided into: (i) social media platforms, (ii) content websites and blogs. A detailed description of the physical touchpoints as supports to brand narrative is presented in other chapters of this book.

## Social Media Platforms

In general terms, luxury shoppers use social media mostly to conduct research and not so much to post their own comments as to repost others'. More specifically, different behaviours can be tracked based on the platforms used by luxury consumers: (i) Twitter is used to learn about or comment on live events in real time; (ii) Facebook, on the contrary,

[1] This kind of approach to storytelling is not totally new and there are many examples that date back in time, like the Japanese brand VAN, owned by Kensuke Ishizu, that introduced the "Ivy style" in the Japanese market in the 1960s: "Van sponsored a radio show called 'Ivy Club'… Ishizu then moved into TV with a half-hour Sunday night show called 'VAN music break', featuring famed jazz and pop musicians performing their hit songs while wearing the latest Ivy duds. VAN was also the first Japanese fashion brand to endorse athletes and race car drivers. Kensuke Ishizu organized an amateur football team called the Vanguards. And, in 1966, he opened a restaurant, VAN Snack, in Ginza, which offered hamburgers three years before McDonald's opened its doors down the street" (Marx 2015).

is accessed when luxury customers are in search of information on promotions or discount coupons; (iii) Blogs and forums on the luxury brands' websites are the touchpoints through which customers might comment about in-store experiences or specific products; (iv) Blogs, managed by influencers, are considered the best tools to discover new and emerging trends (Dauriz et al. 2014).

Geographical distribution of social media and the predominance of certain platforms to the detriment of others are very much related to local cultures and preferences as well as market characteristics. Even on the same social platforms, national or regional cultural differences might call for a different approach to the creation of contents and the engagement of users and consumers. Cultural differences affect the way in which social media shape the interactions between customers and luxury brands (Hudsona et al. 2016) and might require a different approach in the way contents are created and managed. In countries where large groups of people willingly tend to conform with certain trends, such as in the case of China, a broadcaster approach to social media is acceptable. On the other hand, in countries dominated by more individualist cultures, such as the USA, luxury and exclusivity are better created through a communication strategy that appeals to individual achievement and esteem.

An interesting example of content adaptation to local cultures is offered by Rolex, the Swiss watch producer that adopted a different social media strategy to promote the launch of one of its limited series in China and in the USA. In China, Rolex used RenRen, a Chinese social platform, to notify followers that a limited edition of a new watch had been released, stating that only 1,000 pieces of the new model were available. In the USA, the brand notified its Facebook followers that a very rare edition had become available, which could be customized according to individual taste. It then advised followers to check with their local store for availability. Another example of local adaptation of contents for social media platforms was provided by Cartier with the short film *Destinee*, released on social media in January 2013. The movie tells the love story of a young couple whose romance is rekindled with the help of Cartier's Destinee Solitaire ring. The short film, starring Michelle Chen, a renowned Taiwanese actress and an icon to the Asian consumer target, was a real regional success on different social platforms and Facebook in

particular. The French brand succeeded in merging its country of origin values and characteristics with the ones of its target audience, tailoring the story to the Asian market.

When planning its social presence, a luxury brand should take into account: (i) the number and nature of social platforms; (ii) the number and hierarchy of profiles; and (iii) the nature and quantity of contents.

(i) As just discussed, two factors affect the decision on the number of social platforms to be used to promote brand contents and generate engagement with customers and fans: local distribution of different social networks; and nature and characteristics of the customer journey when establishing relationships with the brand and performing a variety of purchase-related tasks. Customer journey can be defined as the route taken by customers when performing complex tasks such as purchasing and shopping, using a different set of touchpoints that could be digital and/or physical (Chaffey and Smith 2013; Li and Hitt 2010). Social media platforms are key influencers for luxury consumers throughout the purchasing process and the integration of such platforms in the design of the purchase experience allows luxury brands to deliver superior customer value and, at the same time, reach out for more potential customers (Hyseni et al. 2015). Chaffey and Smith (2013) define a set of key communicational aspects in the various social activities undertaken by customers while surfing the web. These aspects are clustered into the following categories: competence-based, expert, proactive and dynamic communication flows between consumers and brands. Such communications account for the growing trust between brands and consumers. Trust can be achieved through content creation and sharing in order to provide feedback and support on product and service evaluation throughout the customer journey. The mechanism of trust generated by the quality of the contents implies a clear definition of the different profiles that a brand might adopt to foster conversations with customers and other stakeholders on the different social platforms. While in traditional marketing communications the identity issue was somehow implicitly dealt with assuming the brand as the main identity and source of communication—

through which customers establish relationships with products and services and build their perception of the value expressed—in digital marketing the number of profiles that can be used to address customers might vary dramatically.

(ii) The number of profiles that a brand needs to manage on social media is among the most important decisions a company should take when defining its social presence. There is no general law in this case nor any rule of thumb that might support managers in this decision, but a wide span of options is available that could cover a continuum, from a single identity approach to a portfolio of profiles. The number and nature of possible identities are very much dependent on the kind of storytelling and the differences in contents and topics that the brand is willing to cover. The identity or profile hierarchy is tightly connected to the brand architecture and the nature of the brand portfolio in many ways. If a luxury company were to adopt an umbrella brand approach, striving to create a unique global presence for the master brand, then the number of available identities would be limited, and a clear strategic identity would necessarily play a central role in the narrative process. In other cases, luxury companies might decide to opt for a more complex profile (identity) architecture, taking into account the different regions and markets or the various product lines. In this regard, Dior recently added Dior Cosmetics to its Instagram Dior profile to better support the beauty-related narrative for the cosmetic product lines. Planning a luxury brand's social media presence begins with the identification of the desired set of social media platforms and the number and nature of profiles needed to establish an adequate relationship with customers and fans. Defining a portfolio of profiles implies identifying level of services and nature of contents for every profile, and the kind of brand experience and customer engagement it requires. Once the portfolio has been planned, an editorial calendar with dates of release and update frequency for each profile is prepared in order to manage all scheduled promotional activities.

(iii) The nature of the contents that better fit the profiles of a luxury brand as well as the quantity and frequency of their release represent another step in the creation of a social media strategy. In social media, the quality of visual contents, that is, images and videos, is

crucial and that is where luxury brands naturally excel. Stunningly beautiful designs, high-quality photographs and videos, stories celebrating the brand's heritage, iconic symbols contributing to the creation and perception of the brand's rich identity are the raw materials that may be employed in luxury brand's storytelling, regardless of the channel through which they are conveyed. A reserved communication style goes well with the general image of the luxury industry and highlights the unique and exclusive nature of the products. In terms of formats, there are some major trends that might be exploited by luxury brands: no longer limited to video-sharing platforms such as YouTube and Vimeo, videos are spreading across general-purpose social media like Facebook. A research run by Socialbakers during the 2015 New York Fashion Week revealed not only that more videos were directly uploaded to Facebook than to YouTube, but also a fourfold increase in the rate of direct uploads to Facebook compared to the previous year. Brands like Chanel are increasingly making good use of a strong video content strategy, founded on high-quality video as well as on the collaboration with celebrities and key influencers. In January 2016, Chanel involved its fans in the Haute Couture fashion show, providing a unique VIP perspective through its social media and its brand's best ambassadors, such as Gwyneth Paltrow. The initiative was remarkably successful: the video lasted 2.5 minutes on Twitter, where it drove 7,841 retweets, and just 14 seconds on Instagram, where it generated 184,000 likes and 3,100 comments; both were among Chanel's top performing posts over the period measured.

## Blogs and Content Websites

In order to establish contact with its customer base, a luxury brand should not only focus on its presence on social media platforms, but plan a content strategy to attract traffic to its proprietary sites (often referred to as "owned media" by marketing professionals to distinguish them from "earned media"—such as social platforms, where followers and fans have to be conquered through contents and interactions—and "paid media",

traditional on line advertising such as banners and AdWords campaigns) where a customer profiling activity can be implemented and the span of control over contents and interactions is higher than on earned media.

Blogs and content sites are the two main forms of proprietary sites available for branding and customer relationship purposes. There is no clear definition of the difference between these two digital touchpoints: they might be perceived as the two extremes of a continuum rather than two separate constructs. On the whole, blogs play the role of online diaries while content websites resemble digital magazines with better structured contents and richer media contributions. Nonetheless, walking a fine line between the accessibility encouraged by social media and their own projected sense of exclusivity, luxury brands strive to maintain and reaffirm their elite positioning while generating customer engagement. An interesting example is offered by French luxury conglomerate LVMH and its 2010 launch of Nowness.com, a self-described "daily resource for the culturally curious." In 2011, the site was awarded a Webby for Best Fashion Website and a Clio Award for Best Interactive Website. LVMH allows Nowness to freely express its own creativity, and there is no evident association between the company and the site—which cannot be easily perceived as directly related to the brand. Users can choose whether to simply browse stylish original content from celebrities, or register and participate in the experience by "loving" videos, photos and articles. Registered users also receive personalized recommendations and content updates via email. Gucci provides another interesting example of a content website for mobile users. Its recently launched Gucci Style, a "shoppable" online magazine, features fashion spreads, news and advice, and lets registered customers create wish lists, share contents on their social profiles and locate stores carrying the advertised products through the website's store locator.

## Digital Public Relations

Influencers provide luxury brands with the opportunity to enhance customer experience, showing examples of the adoption of a luxury product by people they can connect to. Three main categories of digital influencers may be employed by luxury brands: (i) traditional celebrities, who have

gained a well-established reputation outside the digital world; (ii) social media stars, such as fashion bloggers, who have built their reputation online—according to the top ten list recently proposed by Fashionista, the most influential fashion blogger is a 28-year-old Italian woman living in Los Angeles, who has an astonishing number of followers on many social platforms (5.5 million on Instagram; 1.2 million on Facebook) and a website called "The Blonde Salad" that is extremely popular in Europe and in the USA; (iii) micro influencers, or social media users with smaller audiences (usually less than 10,000 followers), who may be employed to address niche topics and communities or access areas of specialized expertise.

Influencers and strong brand advocates can help a luxury brand narrate its story on social media, with the distinct advantage of a strong follower base and a reputation for credibility and trustworthiness that may turn them into trendsetters (Booth and Matic 2011). Moreover, their fascination with the brand can be leveraged to communicate the brand's message. This strategy was employed by Swarovski for the launch of their 2014 spring collection along with the #SwarovskiLook campaign. Four international fashion bloggers were selected by the brand to "emphasize the fashionable appeal of its collections, and also to exemplify the diversity of styles Swarovski can actually suit to" (King 2014) and, during the four-week campaign, delivered video content that combined the new spring looks with Swarowski jewellery. Not only did the videos successfully portray Swarovski jewellery as a fashionable addition to everyday looks, they also proved to be an effective tool in reaching the company's target customers while following the rules of social media, without jeopardizing brand integrity.

## The Role of Metrics in Designing and Delivering Rich Multichannel Customer Experiences

When designing and managing a multichannel marketing campaign, a crucial role is played by the choice of a proper set of metrics to assess performance. The use of digital and social media analytics enables luxury

brands: (i) to assess the quality of the interactions during the customer journey; (ii) to evaluate the multichannel overall marketing performance; and (iii) to extract information from the online interactions, identifying consumer trends in real time and discovering new influencers.

Traditionally, marketing managers perceived digital media as an extension of their promotional and direct marketing set of tools. The possibility to track user behaviour through metrics such as impressions and click-through-rate placed digital spending in the realm of the call-to-action initiatives. This misperception of the role of digital touchpoints might account for the initial scepticism over digital channels and media from luxury brands. The integration of digital media in a wider perspective and the adoption of an experiential approach to marketing practices helped marketers to reframe their perceptions and start regarding digital media not only as promotional tools but also as an integral part of their marketing efforts. In this sense, digital media and social media platforms may host marketing initiatives aimed not only at generating call-to-action effects but also at reinforcing the narrative power of brands, engaging customers in deep brand relationships and increasing the equity results for the brand (Boaretto et al. 2009).

In the perspective of a seamless customer experience, the distinction between digital and non-digital marketing metrics tends to become blurred: "as typical buyers we did not think in terms of channels. We just sought the most convenient way of accomplishing our goal. From the multichannel marketer's point of view, we exhibited cross-channel behavior." (Arikan 2009).

Marketing metrics may be applied to a single channel performance, such as a social platform initiative, or they might measure a set of more complex interactions that are typically related to cross-channel marketing initiatives or customer behaviours.

The choice of a proper set of metrics is dependent on the overall marketing goals of the campaign. Even in the case of the same touchpoint, key metrics might vary dramatically, depending on the purpose of the preceding marketing actions. Depending on the overall marketing goal, for instance, different criteria may be employed in the evaluation of a social media campaign. A marketing objective that is related to brand awareness may require metrics that measure the increase in conversations and their reach (on the same platform and cross platforms), and the number

of mentions compared to competing brands during the campaign period; a PR campaign on the same social platform may be assessed through measures focusing on the nature and quality of the influencers that were engaged over a certain period of time. The use of a social platform to enhance customer care and add additional services will require a set of performance indicators measuring the level of customer satisfaction, the number of customer requests that were satisfied, and the response time.

When brands adopt a multichannel approach, an integrated set of metrics is crucial in order to assess the quality of the overall investment. One of the main barriers to this approach to the evaluation of marketing initiatives is related to the frequent disproportion between digital and traditional marketing investments, especially when it comes to luxury brands: "The impact [of digital spending] may in fact be so small that it gets drowned out by larger campaigns running in parallel" (Arikan 2009). The need for multichannel metrics arises when adequate and meaningful online spending can be compared, in terms of intensity, with the one on traditional media.

Multichannel metrics are strongly related not only to the overall marketing goals, but also to the nature and characteristics of different customer journeys. The measures adopted should evaluate the quality of the interactions in the single touchpoint, in terms of experience provided and effectiveness in allowing customers to perform their planned tasks and the planned cost. These metrics should be integrated with those assessing different channels' conversion rates, that is, their ability to push customers forward to the next touchpoint in their journey.

## Integrating Customer Experience Through Different Channels and Media: A Future Perspective

In the near future, it will seem impossible to talk about online and offline customer experiences as if they were unrelated: all differences will be removed in favour of a seamless experience for customers, who will surf between physical and digital touchpoints. The evolution towards a fully integrated seamless experience is being pushed forward by two separate yet interconnected drivers: (i) the growing ability of devices to interact with

the environment (often referred to as "the internet of things") and (ii) the ever-increasing quality of digital content allowing individuals to add layers of virtual and augmented reality to their everyday experiences. Mobile and wearable devices will allow consumers to develop deeper interactions with their surrounding environment, reshaping interactions between people and products in physical places such as stores and boutiques. One such technology is known as "beacons", small devices embedded in signs or displays that can push information to nearby smartphones. At the same time, augmented reality will progressively hybridize physical and digital experiences: a small yet meaningful example is provided by try-on software that allows customers to virtually wear jewellery or accessories without needing to physically head to stores or boutiques, as mentioned earlier. Try-on software may also be employed to dramatically reshape the changing room experience: customers have the opportunity to virtually try on clothes and accessories with the aid of digital mirrors, while product availability and recommendations based on individual tastes and previous purchases are displayed. The Prada store in Manhattan, designed with the contribution of IDEO, has been a pioneer in the use of digital technologies to enhance in-store customer experience. Even small luxury brands such as made-to-order shoemakers have been conducting similar experiments: digital mirrors help customers evaluate the feel of the final product during the purchase phase and modify it in real time according to their tastes and preferences. Makeup brands are experimenting with live three-dimensional facial recognition in existing features on apps and websites, allowing customers to try makeup and products directly on their face through online interactions. Three-dimensional facial recognition will permit a richer interaction with products and greater freedom of movement for the customer who, at present, can only upload a selfie and test products on a static image.

The internet of things and the possibility to embed digital information within objects and spaces entails a whole new area of expansion for luxury brands, which may provide a unique mix of craftsmanship, narrative and aesthetic experience to the customer's interaction with the environment. In the last few years, several interesting experiments have been conducted in this field, such as those by Tory Burch range for Fitbit, which turns wearable fitness technology into high-end fashion jewellery, or the wearable maker Misfit that created "Shine", a customizable series of fitness trackers disguised as jewellery, in partnership with Swarovski (Todaro 2015).

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# Part 4

## Growth for Value Creation in Luxury Industries

# 13

# Growth Archetypes in Luxury Companies

Emmanuelle Rigaud-Lacresse and Fabien Seraidarian

## Building Sustainable Competitive Advantage Using a Framework Rather Than a "Ready-Made" Strategy

The luxury industry features sustainable internationalization of the market in response to growing demand, and the remarkable development of large luxury groups. The industry is mature, making it more difficult to deal with client expectations and to cope with

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new competitors. Researchers have analysed many different growth strategies. This chapter does not describe how luxury firms implement successful growth strategies, although this would be an interesting ex-post rationalization exercise. Nor is it our aim to envisage the best possible strategic paths for the luxury industry. Our ambition is to present a framework for how to build growth strategies in a dynamic environment. In science, a good theory combines compelling hypotheses that subsequent experiments will confirm. A good strategic theory similarly comprises hypotheses about how firms can develop and create most value. As detailed in Chap. 8, our theoretical framework is based on the industrial and resource-based views. From that perspective, growth strategies result from anticipating the future evolution of the industry, based on major trends as well as weak signals. Strategies also need good insight into what is distinctive and uniquely valuable in the company's assets and capabilities. The company then assesses which combinations of internal and external assets and opportunities can create value. Thus, a luxury company whose strategy has a good theoretical basis should have no trouble selecting an effective good new strategy. This chapter provides a framework for luxury firms based on an in-depth study carried out in French luxury companies in 2014.[1] The framework comprises (1) key levers divided into three sections (strategic focus, organizational settings and stakeholder ecosystem), (2) a typology of luxury firms and (3) a sector based approach to look at value chain configurations. In other words, instead of normative growth strategies we focus on a bottom-up, expertise-based perspective that combines the industrial and resource-based views. First, this chapter depicts briefly new trends that call for a revisited approach. Then we describe our framework to build successful and sustainable growth strategies. In the last section, considering the French luxury industry we implement our proposed framework and discuss issues and challenges. The conclusion emphasizes the plausible scenarios according to the strategic role of know-how and expertise in the development of luxury firms.

[1] Seraidarian (2014) –http://fr.zone-secure.net/publications/8708/46460/?startPage=4.

## New Trends in the Luxury Industry Calling for a Revisited Framework

Luxury companies have been growing steadily for many years and luxury players long believed they were invincible. Various economic trends did not really impact the luxury industry until 2008. The global financial crisis was a turning point for the luxury industry: although growth has slowed, it has continued, launching the perspective of a new paradigm that blocks the historical dominance of large groups (Kapferer and Bastien 2012; Som and Blankaert 2015). In particular, digitalization makes globalization possible for luxury small and medium-sized enterprises (SMEs). On the demand side, consumer behaviour is evolving and modifying the "rules" of the luxury sector (Okonkwo 2009). Now, connected luxury clients have access to product information and are looking for unique high-quality products. The development of the luxury industry continues to be fed by emerging countries, and increasingly well-educated and selective clients want rare, high-quality products. In other words, "logomania" is losing its importance in favour of other emerging luxury values reflecting changing times. After the move towards popularization to enlarge market segments, the luxury industry aims to reinvent itself and regain its status in line with the environment. The crisis was thus a wake-up call for the luxury industry (Som and Blanckaert 2015, p. 19).

How is this paradigm shift impacting value chains in the various luxury sectors? To create value, firms are looking for sustainable development as the environment evolves, to secure their value chain and competitive advantage. These market dynamics affect luxury organizations as they entail change in value chains. Firms aim not only to develop and create value but also to maintain competitive advantage. To compete globally, luxury companies have to build new capabilities to access resources, skill sets, production capacity, the labour market and funding for their development. In the luxury network firms' profiles are extremely varied depending on their activity and their position in the value chain: some are international organizations many are small scale companies or artisans. Each uses its resources, competencies and capabilities to create value and sustainable competitive advantage (Depeyre and Seraidarian 2015).

The luxury industry is not uniform, but a collection of sectors facing different challenges and issues. For example, although there are 18 and 40 companies respectively in glove-making and fur, there are more than 200 in leather goods, nearly 300 in jewellery and over 1,000 in ready-to-wear and haute couture. Notwithstanding the relative sizes of the sectors, three main categories of actors have emerged:

- Microbusinesses, whose very existence is founded on the expertise of their craftspeople.
- Medium-sized enterprises that are active on several links in the value chain or that have significant production capacity.
- Large groups capable of optimizing their position along the different links in the chain and with the resources to meet their markets' requirements (product portfolio, international presence, service quality, distribution networks, etc.).

Thus, luxury brands implement various business development plans and strategies depending on multiple contingency factors: cost-cutting, downsizing to preserve gross margins and financial restructuring coexist with quality enhancement, investment for differentiation and expansion (geographical expansion or launching new product ranges to enhance brand value). Repositioning is also an option, as is doing nothing and just waiting (Som and Blanckaert 2015).

These strategic choices, organizational changes and the changing environment are transforming the different sectors' value chains: integration of activities, outsourcing or relocation of manufacturing activities. Clients and subcontractors are developing new practices in response to production needs. These reconfigurations require repositioned players, new manufacturing processes and adjustments to traditional expertise. One key challenge is finding the best configuration to keep and value specific knowhow, consolidate brands and communicate unique experience with added value to heterogeneous clients. What can new luxury business models look like? Are they fully integrated or a "game" shared by suppliers, brands and retailers? The choice depends first on sector and position on the value chain. The next section describes a framework for how to build sustainable growth.

## A Proposed Framework for Luxury Growth Strategies

The proposed framework brings together key dimensions that luxury firms should consider when developing their growth strategy. It results from in-depth analysis of around 70 meetings and interviews with companies and federations.

- A theoretical approach to examine a range of key questions dealing with strategy, organization and ecosystem.
- A typology of configurations to look at relevant positioning and organizational settings.
- A sector-based perspective to consider specificities of the sectors that depict the luxury industry.

### The Three-Dimension Model: Key Questions to Build a Sustainable Growth

This is exemplified by the three-logic model combining a number of key levers for success in the luxury industry: strategic focus, organizational settings and creation of an ecosystem. Knowhow and expertise are at the core of the three-dimension model (Fig. 13.1), ensuring sustainable strategy for luxury companies. In other words, workable paths that promote development result from the following questions:

- What are the key strategic issues regarding value chain dynamics? What are the development and innovative challenges? How can financing and transmission issues be tackled?
- What are the specific features of the internal value chain from design to distribution? How can manufacturing capacity be expanded? What are the relevant organizational settings? How the required knowhow for the manufacturing process be imparted?
- What kinds of network can develop a virtuous strategic path (coopetition…)? How can the company's legitimacy (institutional stakeholders…) be developed? What are the foundations of the firm's sustainability (territorial origin)?

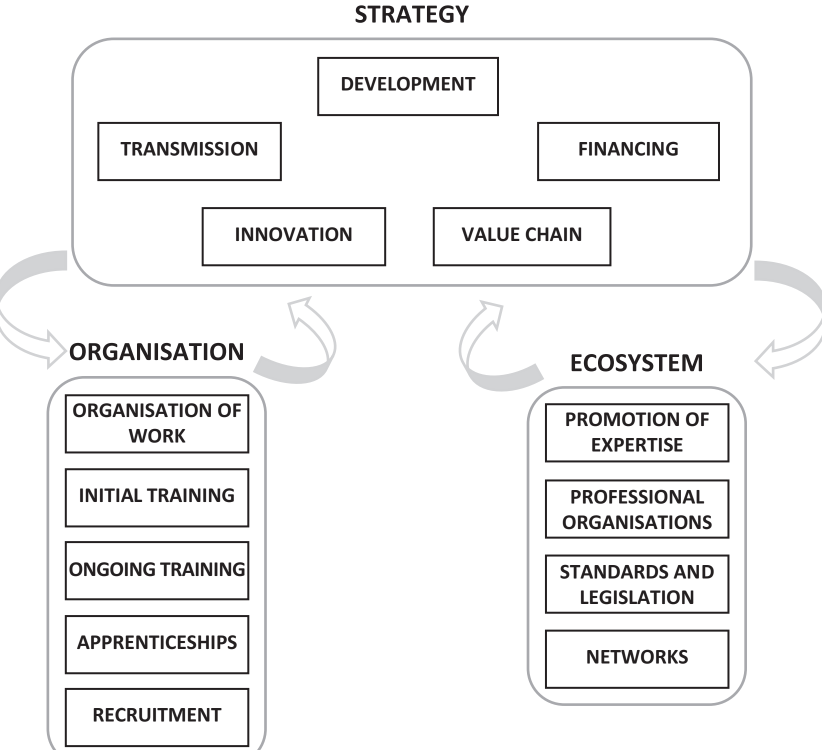


**Fig. 13.1** The three-dimension model to build sustainable growth strategies

## Firm Typology: Organizational Settings for Sustainability

However, the significance of the three-dimension model depends on the type of company and its position on the value chain. To distinguish between the different companies, our analysis revealed the coexistence of five configurations within each sector based on level of expertise (availability of competences on the labour market, strategic importance of knowhow, etc.) and the ability to perpetuate knowhow (critical size…). The graph in Fig. 13.2 positions the different types of companies in the luxury industry.

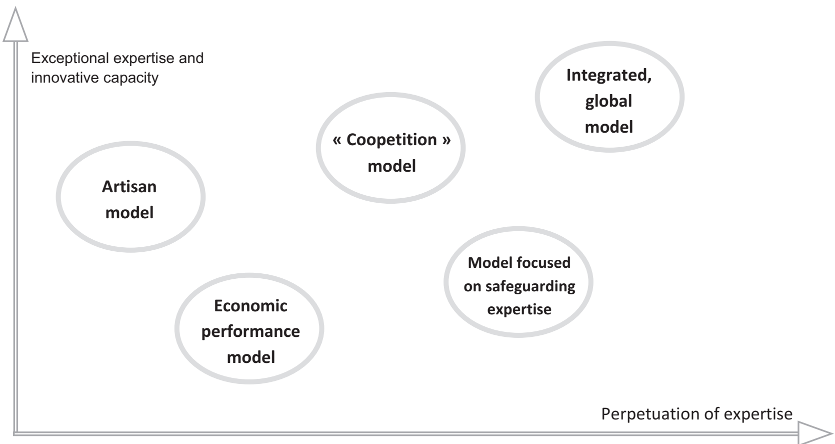


**Fig. 13.2** Typology of luxury firms considering expertise and knowhow

- *Craft model*: recognized, tacit but fragile expertise, as transmission is not guaranteed; limited presence on the value chain with a high level of dependence.
- *Economic performance model*: expertise processed in response to demand with streamlined relations between stakeholders.
- *Expertise preservation model*: traditional, exacting expertise (recruitment, training, etc.), with strategies relying on partnerships or sales/acquisitions, depending on the balance of power along the value chain.
- *"Coopetition" model*: exceptional expertise promoted through relationships with direct clients down the value chain and successful own brands in France and abroad. Partnerships and cooperation pursued with direct clients and distributors.
- *Integrated, global model*: expertise promoted internationally by brands in optimized value chains. Ability to work with the best subcontractors.

These configurations are all consistent and demonstrate their competitiveness on the luxury market. But from the craft model to the integrated model, each configuration is increasing its sustainability and value creation potential. For what is at stake here is the way to switch from one configuration to another: how to expand the craft model to the economic performance model or to the coopetition model?

## Sectors: Value Chain Configurations

Alongside type of company, sector is the other major contingency factor, that is, a key dimension to consider when implementing the framework. The luxury industry comprises a broad range of very different sectors. A great deal of knowhow is required to create and manufacture luxury products. This expertise is specific to each sector and position on the value chain (which account for company size). We will explain the issues each sector faces when elaborating a sustainable growth strategy in each part of the framework. For the luxury industry a breakdown by turnover size class distinguishes the sectors.

- *Major sectors*: this category is filled in with the fashion and eyewear industries. Representing the main sectors, they are facing specific challenges. The fashion sector is a mixed industry (haute couture, ready-to-wear, textile and confection) with a fragmented value chain featured with subcontracting practices to link creation to confection or manufacturing to distribution. Due to specific knowhow the sector faces a challenge to operate the transmission of expertise from one company to another or between generations of craftspeople. The eyewear industry is a robust market with the coexistence of the optics and sunglasses markets. The value chain is highly integrated with highly-technological expertise and semi-industrial production.
- *Growing sectors*: in this group we gather three developing sectors—jewellery, watches and leather goods. Compared to other products, the leather goods sector has experienced high growth since 2010 to become *the flagship* of the luxury industry. The leather goods sector faces significant recruitment needs, workshops have to train new staff. Among issues on the value chain, the sector deals with problems with leather supplies: tanneries taken over by large groups to control supply better (quality, quantity…). Jewellery faced the financial crisis which unsettled the industry, but the different players have resisted the crisis fairly well: the network and savoir-faire have been maintained. Brands concentrated in four large groups, very specialized, independent jewel makers working as subcontractors and small, independent craftspeople. Due to the increasing market independent brands are developing and some of them have been recently bought

out by large groups in the sector: for example, Pomellato, Qeelin, Harry Winston and Bulgari. The watch sector is divided up between the Swiss giant Swatch Group, with a near monopoly over movements, large groups (e.g., Richemont and LVMH) and a few independent French manufacturers and suppliers. The dominant "Swiss Made" Label remains increasingly powerful. Downstream on the value chain, retail channels undergoing radical change: from multiple brand to wholly-owned stores.

- *Niche sectors*: in this class we regroup gloves, fur and footwear. These sectors try to enlarge their markets working closely with haute couture and renown brands to propose made-to-measure products. In these sectors, capabilities and knowhow are highly specific: the manufacturing processes are integrated. Upstream the firms are looking for materials and components and downstream for distributors. Diversification is a key growth strategy to value knowhow as Camille Fournet or Fabre demonstrate with great success.

Far from being homogeneous the luxury industry brings together small and global companies with a narrow or large positioning on the value chains to be investigated to identify a virtuous development path.

## The Framework in Practice: Critical Approach to Luxury Growth Strategies

A recent report conducted for the French government by one of the author[2] discusses luxury sectors devoted to personal products and emphasizes the key features that will ensure sustainable growth all along the different value chains. Each sector of the luxury industry differs in size and growth perspective: turnover, growth rate, internationalization and so on. Indeed, gloves, jewellery and apparel manufacturers have widely differing features. Competences and capabilities are also diverse: specific knowhow such as procuring and working with raw materials, interacting with buyers, task scheduling and so on.

[2] Seraidarian Fabien–Mazars (2014), *Les savoir-faire dans la mode et le luxe : quels enjeux pour la filière française,* http://www.mazars.fr/Accueil/Secteurs/Distribution/Luxe/Les-savoir-faire-dans-la-mode-et-le-luxe.

Considering the French luxury industry, we illustrate the proposed framework looking at the three dimension-model and the different sectors to point out some key issues and challenges for luxury firms.

## *Strategic Focus:* A Value Chain Approach to Promote Cooperation and Innovation

Based on the economic data and value chain positioning of the firms involved in the study, the charts in Figs. 13.3, 13.4 and 13.5 assess the potential of each sector. The current positioning is based on market size, the number of companies and the identified risk of breakdown along the value chain. We base our estimate of development potential on prospects for growth and the availability and criticality of the expertise needed to develop production tools.

The fragmented manufacturing process along the value chain causes power imbalances between firms and, in some cases, an unfair distribution of value. This situation, which can be more or less pronounced depending on the sector, weakens the value chains and explains operations and reconfigurations: the purchase of tanneries to secure upstream supply sources for leather goods; the acquisition of SMEs with rare expertise, the creation of own brands and the development of dedicated distribution networks (retail vs wholesale). These major changes to the value chain affect know-how and expertise. For example, the buyout of SMEs by large groups helps to maintain traditions, while internationalization and the development of series production increases the division of labour (Fig. 13.3).

The luxury industry must consider strategic issues if it is to develop sustainable competitive advantage:

- The risk of losing expertise and of breakdowns in the value chains of certain sectors such as fur, footwear, components, etc.
- Margins considered too low in some cases, limiting subcontracting development capacities and the purchase of new equipment, combined with payment terms affecting cash flows.
- Tension in the supply of raw materials and components for major brands.
- Difficulties in taking over and conveyancing companies.

| | | |
|---|---|---|
| **Leather goods** | | International recognition of major brands' leather goods and an increase in production carried out in France. Potential remains significant, although there are serious challenges in terms of hide supply, which could curb development. |
| **Footwear** | | A declining sector with disappearance of the industrial fabric. Positioning too focused on the low –to midmarket segment. Designers are revitalizing the sector, though. Real potential in the upmarket and luxury niches, but major financial challenges for development of the sector. |
| **Gloves** | | Very few actors. Activities limited by distribution capacity. There is however potential in terms of diversification, niche markets and internationalization. |
| **Fur** | | Craft production with limited production capacity. Some furriers are on modernizing fur by tying it in with haute couture. Strong export potential that is being implemented but with require a reconfiguration of the value chain. |
| **Apparel** | | Paris has undeniable name recognition thanks to its specific expertise and value chain configuration. Solid presence of French fashion, but heavy competition and weight of more relative expertise. |
| **Jewelry** | | Brands with recognition abroad, although workshops need to cooperate and increase their production capacities to be able to respond to growing demand and boost their margins. |
| **Watches** | | Thanks to recognize expertise, France is well-positioned on servicing/repairs and micro-techniques, but those activities have limited potential. Dominance of "Swiss Made" but potential for the development and promotion of French expertise in manufacturing components for Swiss brands. |
| **Eyewear** | | Mid-to upmarket French positioning. Sector dominated by Luxottica. Potential on niche markets (like Minima, Bonnet, etc). Current positioning Potential for growth |

Current positioning Potential for growth

**Fig. 13.3** Strategy: diagnosis and potential for growth

**New Best Practices: An Industry United around a Strategic Issue**

In August 2011, CIPEL, a dyer specializing in fur and globally recognized for its expertise in astrakhan and reversible products, shut its doors. Several of its furrier clients purchased the dyeing business and the fur dressings that they considered to be indispensable. The company reopened in December 2011 under the name of Tanneries de Paris (TDP). TDP, which is run by Maxime Claret, sells in France and abroad (40 % exports) and employs a staff of 20.

As described above, the luxury industry needs to better encourage cooperation (pooling equipment, tools and skill sets). Innovation will also enable young designers and new brands to position themselves on markets. Among initiatives, several recommendations for the French industry have been identified:

- Promotion of innovation to cross-connect and modernize expertise with support from networks and federations.
- Creation of an investment fund specific to luxury goods, to help protect brands.
- Resource pooling in support of canvassing and market penetration by subcontractors and young designers, particularly abroad.

## *Organization:* Need to Align with Internationalization and Value Chain Reconfiguration

Each craftsperson, company and firm has its own knowhow and, over the years, develops an organization dedicated to designing, purchasing and manufacturing products or components. Depending on the sector, the organizations looked into by the French study either generate risk (the leading two being critical mass and available skill sets) or opportunities (knowhow evolving through the use of technology) in relation to expertise. The chart in Fig. 13.4 puts the different study sectors into perspective, highlighting the robustness of current organizations and the potential for development of expertise and innovation, such as in furs and jewellery.

The changing environment, market evolution and value chain dynamics are leading luxury companies in the different sectors to adapt their organizations in pursuit of critical mass, versatility in the workshops, apprenticeships and the transmission of expertise. To respond to these challenges, the development of cooperation through partnerships and the pooling of skill sets and equipment can help workshops to network geographically, and also makes it possible to offer general subcontracting packages to major brands. As far as organizational settings are concerned, the study highlights several issues:

| | | |
|---|---|---|
| **Leather goods** | | Growing need for skill sets with vacancies that are difficult to fill. Shortage of available workshops for young designers. Disappearing expertise in trunk and case making. |
| **Footwear** | | Brand-specific expertise but limited manufacturing capacity for luxury goods via subcontracting. Expertise is disappearing, namely in terms of boot-making. |
| **Gloves** | | Historical expertise that has evolved thanks to ties with fashion, plus potential in terms of product and market diversification. |
| **Fur** | | Risk of disappearance of garment-making expertise. A single operator performing dyeing activities. Innovative dynamics: an innovative partnership between firms and research, for the development of expertise (Drylag). |
| **Apparel** | | Recognized expertise in companies that are often fragile, dedicated to haute couture and upmarket ready-to-wear. Implementation of job versatility. |
| **Jewelry** | | Technological innovation in design/manufacturing and extraordinary manual expertise for manufacturing. Professions under threat (polishers, jewel cutters and gem setters), in turn putting the sector at risk. Establishment of career and skills management practices. |
| **Watches** | | Significant innovation in parts machining for watches, but disappearance of the industrial fabric for the sector's other components. |
| **Eyewear** | | Expertise that is both industrial/highly technological and manual (finishing activities like polishing, gilding, etc.). Major innovations in the manufacture of frames and components. Independent design expertise. |

Current positioning  Potential for growth

**Fig. 13.4** Organization: diagnosis and potential for growth

- increased risk of the disappearance of expertise and smaller workshops;
- workshops need to be more flexible in most sectors to meet buyer requirements; and
- isolation of subcontractors.

To promote new work configurations, several perspectives could be considered resulting from in-depth interactions with luxury companies, such as the creation of local networks to promote the intangible assets represented by expertise, the promotion of cooperation between more innovative peers to encourage "coopetition" (cooperation + competition). But the main important challenge is for companies to clarify their expertise, so as to facilitate its transmission and development.

As a consequence, maintaining and developing expertise requires constant training (initial, ongoing and apprenticeships) to provide companies in the different sectors with a base of core competencies. Our sector-based analysis reveals the disappearance of training into sectors. Moreover, apprenticeship systems and lifelong learning are not suitable for many of the actors interviewed. Because of the dynamics of demand, skilled labour needs are not being met in certain professions (tailors, bootmakers and cutters) and sectors (leather goods, jewellery and fur). The main issues identified for the luxury industry are:

- training needs to be linked to target profiles and skill sets (technical foundations, etc.);
- shortage of skilled labour and recruitment problems; and
- disappearance of certain professions.

**New Best Practices: Partnerships with Schools**

Hermès plans to open two new leather goods workshops in Franche-Comté in 2016 with the support of Ecole Boudard, an artistic leather-working school, to train its future employees. Founded in 1837, the world-renowned Hermès (famous for its hand-stitching, leather goods, fashion, perfumes, table arts and more) employs more than 11,000 people worldwide and has 315 exclusive retail shops, including 203 under its direct control. Despite its international scope, Hermès remains true to its artisan expertise.

Another example, Repetto, which makes ballet flats, created its own training school in Dordogne in 2012, close to its production centre in Excideuil, giving it access to human resources trained in the leather-working professions and, in particular, the "turn-shoe" process. Created by Rose Petit in 1947, at the request of her son, Roland Petit, Repetto's ballet flats enjoy international success and made €60 million in turnover in 2012.

To attract talent and perpetuate expertise, the industry must develop recognized training programmes offering advanced qualifications. In other words, the industry requires a framework to simplify the learning process and thereby make careers more attractive, to encourage the development of skill sets and facilitate on-the-job versatility.

- First-rate school or training centre for handicraft.
- Systematic process for funding apprentices to learn critical expertise.
- Employment observatory for the fashion and luxury goods industries.
- Assistance for companies to ensure the smooth transmission and development of their expertise.

To match business objectives, luxury firms need to adapt their value chain so as to expand manufacturing capacity to meet the increasing demand. Apart from dealing with scarcity of resources and competences organizational settings must lower risk and introduce polyvalence.

## Ecosystem: From Institutional Settings to Services Optimizing the Value Chain

Expertise is the result of a lengthy learning process, sometimes rooted in local tradition. Many organizations keep a record of their expertise and represent artisans and industry firms. But not all sectors enjoy a favourable ecosystem and structures capable of supporting actors during their development. The different sectors are endowed with multiple structures that traditionally lean toward a representation of the actors based on their link in the value chain and offer only a poor understanding of the chain's overall performance and of the issues associated with expertise. The chart in Fig. 13.5 puts the quality of the ecosystems into perspective. Of the federations interviewed, many are now looking to adopt an operational position in the form of programs, services and tools for their members.

In developing countries and in France the large number of structures and the lack of clarity in the products and services offered by professional organizations reduce the impact on the fashion and luxury goods industry

| Leather goods | | French brands with international recognition. Existence of manufacturing clusters created by clients along the value chain. Major jobs potential in the sector, encouraging the strengthening of the clusters. |
|---|---|---|
| Footwear | | Largely compromised industrial fabric. Arrival of young brands creating potential for the sector. A cluster still exists in Romans for the luxury segment. |
| Gloves | | Very few actors, located in geographic concentrations but with an unexploited potential for networking. |
| Fur | | Restrictive, fragmented representation of the sector in response to environmental standards that are a burden on certain links in the value chain, active anti-fur lobbies and draft bills threatening the future of livestock farming. |
| Apparel | | An ecosystem favorable to design in Paris. Jobs pools still exist, although garment-making pools are weaker. Interest in French-made goods. Local initiatives could be reinforced (Pôle Mode Ouest and Creuset Innovation) and ties to the textiles industry could be developed in the interest of innovation. |
| Jewelry | | Workshops located closed to their direct clients, but with little or no cooperation. Manufacturing professions not sufficiently valued and promoted. The plan for a research/design/manufacturing cluster in Parisian companies appears promising for the promotion/development of expertise. |
| Watches | | Dominance of Swiss-made products. Support required for France's future in servicing/repairs and micro-techniques. Potential for specialized subcontractor networks. Synergies to be developed with other sectors. |
| Eyewear | | An Italian actor, Luxottica, holds the majority of licenses. A united federation. Subcontractors geographically removed from their clients. Potential for inter-sectorial innovation (medicine, innovative materials, etc.) |

Current positioning   Potential for growth

**Fig. 13.5** Ecosystem: diagnosis and potential for growth

and its members, despite recognized initiatives and achievements, like the platform developed by the Maison du Savoir-Faire. To make the most of the ecosystem, several actions could be discussed:

- fragmented political representation in certain sectors; and
- substantial operational expectations from members of professional organizations.

Members of federations and professional organizations want to provide easier access to their services by simplifying their portfolio and making project support mechanisms clearer. In response, the ecosystem needs to be reconfigured to create expertise and host clusters of federations,

Chambers of Commerce and Industry, employment offices, national education and the whole of industry. In this context, federations and all other stakeholders would become the industry's partners:

- setting up of operational tools for all actors in the various sectors; and
- encouragement of cooperation or even mergers between certain organizations to steer the different value chains.

**New Best Practices: Maison du Savoir-Faire et de la Création**

The mission of La Maison du Savoir-faire et de la Création is to promote French fashion companies with unique artisanal and industrial expertise, and to then make that available to brands and designers through support and guidance tools and services. The Parisian firm is the only one of its kind in Europe, offering guidance to brands in developing their models, based on a variety of options: access to its premises, business meetings around the subject of expertise, management of an online sourcing directory (apparel contractors' platform), and so on.

Developing the attraction of handicraft jobs and promoting expertise is also of utmost importance. The skill sets and talents of the fashion and luxury goods industries are insufficiently promoted within companies and, more generally, in society. In every sector, companies struggle to find candidates suited to their professions (e.g., polishers). Consequently, the recognition of expertise is a major issue for the industry's development and can help to boost regional appeal, as the Luxe et Excellence Association has done in the Limousin region, where it brought together 18 luxury goods companies. Traditionally the main issues to face are:

- manual professions offering jobs that are unfamiliar to today's youth; and
- disappearance of certain professions.

Last but not least, firms develop their own communication on expertise but, at national level, handicrafts still need to be promoted in order to inspire interest and attract talent.

- improvement of transparency in manufacturing;
- communications about labels;
- enhancement of the appeal of manual professions amongst young people; and
- use of the recognition of training and apprenticeship mechanisms to promote expertise in companies.

## Conclusion

Companies can use our framework to find the best configuration to keep specific knowhow, consolidate brands and communicate unique experience with added value to heterogeneous clients. In line with our typology of sectors and firms, what could new luxury business models look like—a fully integrated model or a collaborative "game" between suppliers, brands and retailers?

We divide potential growth strategies into categories, with regard to the strategic importance of knowhow, discussing three scenarios (Fig. 13.6).

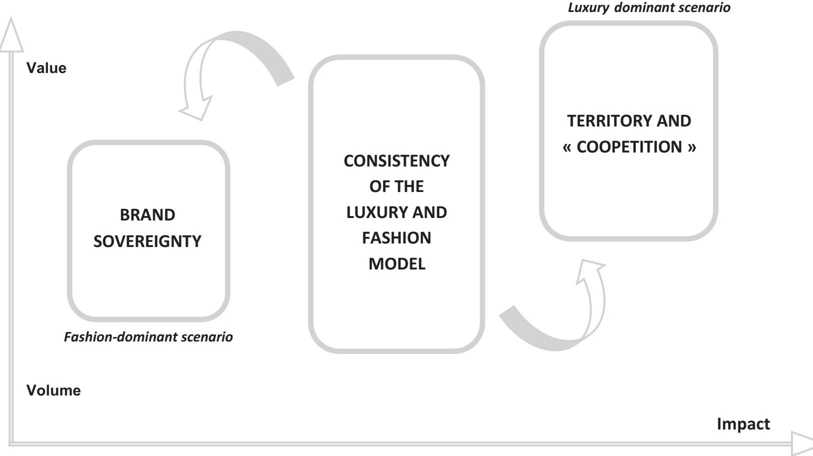


**Fig. 13.6** Scenarios for coherent and sustainable growth strategies

### The Brand Sovereignty Scenario

In this fashion-dominant scenario, development is drawn by brand appeal, which takes priority over product quality and expertise. In the design phase, for example, showrooms become the norm rather than catwalk shows. Product lines are adapted to the different markets.

### Mature Scenario for the Luxury and Fashion Model

In this scenario, the industry's development is still driven by large groups. The sustainability of the industry and its expertise in France is ensured by the promotion of healthy practices: codes of good conduct, a fair distribution of added value along the value chain and guidance provided to subcontractors by direct clients.

### Territory and Coopetition Scenario

In this luxury-dominated scenario, subcontractors offer differentiation in their service portfolios, in their technological specializations or in their organizational expertise, inciting clients to make use of their services and to invite them into a network.

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# 14

# Integration of Mergers and Acquisitions in the Fashion and Luxury Industry

Barbara Quacquarelli

In the global mergers and acquisitions (M&A) scenario, fashion and luxury is one of the most important industries for numbers of deals and for the strategic use of M&A for business growth. The increasing number of deals all around the world in this industry is a fact and serial acquirers dominate it: from 1999 to 2014, luxury groups of developed markets that made serial acquisitions represent 71 % of the value of M&A deals and 69 % of the M&A deals in the whole industry.

Although the M&A process is common in different companies, not all the M&As are alike (Bower 2001): in the fashion and luxury industry it is important to choose how much should be integrated and a key dilemma is the decision about whether to integrate the newly acquired organization and what degree of autonomy the acquired management should be granted. The creativity, often embedded in artisanship, is one of the attractive elements for an acquirer company that undertakes an M&A deal in the fashion industry. There is a high risk of poor integration management post M&A: the departure of key creative talents and loss of knowhow.

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There are many analyses from financial and strategic perspectives, but few are contributions on value creation after the deal, analysing the integration of structures and processes as predictors of M&A performance. How can acquirers avoid the problems and increase the chances of success? The reason for failure is often an inappropriate post-merger integration strategy.

The M&A performance depends on the integration process. In creative-intensive industries, like fashion, many studies examine two main dimensions, which improve the organizational performance: the knowledge sharing and the employee retention. In the fashion and luxury industry, there is a high risk related to losing creative talents, but submitting creative talents to an intensive knowledge sharing with the acquirer, there is a risk of changing and influencing them too much, losing the uniqueness and specificity of the group of designers, and with them the target identity. To avoid the homogenization of the creative visions of the different companies in the same group, it can be interesting to choose an ambidextrous approach, like my acquirers have learned, more tight and replicative on commercial and marketing functions, more loose and path-dependent on production and creative functions.

The critical dimensions to develop synergies are related to choices about integration depth (what and how to integrate).

What is important in fashion M&A management? How important is the human capital in M&A success? This chapter tries to answer these questions, analysing and comparing the literature with the actual practices used by serial acquirers in the fashion industry (e.g., LMVH, Kering Group, Prada, Only The Brave).

## Main Global Players in M&A Operations

Few strategic buyers and many private equity and sovereign wealth funds dominate the acquisitions in the fashion and luxury industry. All of the top players in the fashion and luxury industry are serial acquirers: for example, Louis Vuitton Moet Hennessy group (LVMH), Kering group, Richemont, Prada, Luxottica and Only the Brave (OTB). These players are mainly based in France and Italy (Table 14.1).

In these countries, first, we find the French LVMH group and Kering group, then the Italian groups, the Milanese group Prada, and the Venetian group Only the Brave (OTB).

**Table 14.1** Countries of luxury companies' headquarters

| Country | Number of companies | Average luxury goods size (Mil USD) | Share of top 75 companies (%) | Share of top 75 luxury goods sales (%) |
|---|---|---|---|---|
| **France** | **11** | **4.275** | **14.7** | **27.4** |
| **Italy** | **23** | **1.391** | **30.7** | **18.6** |
| Spain | 3 | 802 | 4.0 | 1.4 |
| Switzerland | 6 | 4.608 | 8.0 | 16.1 |
| UK | 5 | 987 | 6.7 | 2.9 |
| US | 17 | 2.433 | 22.7 | 24.1 |
| *Top75* | *75* | *2.290* | *100* | *100* |

*Source:* Global Powers of Luxury Goods 2014, In the hands of the consumer, Deloitte report 2014

From the late 1990s up to the year 2015, the two major French giants have embarked on several M&A deals, acquiring many of the leading companies, symbols of luxury and fashion made in Italy (Fig. 14.1). Italy is a fertile field of potential targets for M&A deals.

The main target companies in M&A transactions undertaken by two French holding companies are identified in the historically grown organizations in terms of quality and production expertise. Companies like Gucci, Sergio Rossi, Bottega Veneta, Brioni, Pomellato and Richard Ginori 1735, are now part of the "business park" of Kering holdings. The holding company LVMH, is not short of brands belonging to the Italian luxury industry, including companies historically defined by characteristics of quality and production knowhow, such as Fendi, Pucci, Acqua di Parma, Rossi Moda, Bulgari, Loro Piana and Marco DeVincenzo.

The Kering group, formerly known as Pinault-Printemps-Redoute (PPR), is a French multinational holding company founded by entrepreneur François Pinault. Today Kering includes a worldwide group of brands (luxury division, sport and lifestyle division and retail) distributed in 120 countries. Kering's shares are listed on Euronext Paris CAC 40 index. The other group across the Alps, as previously mentioned, is LVMH.

LVMH, as opposed to Kering, has a product portfolio with a high diversification rate, monitoring organizations operating in different industries such as wine and spirits, fashion and leather garments, perfumes and cosmetics, watches and jewellery. LVMH has also undertaken M&A deals to add items within its value chain, through the acquisition of distribution channels, such as Sephora, and communication (Group Les Echos).

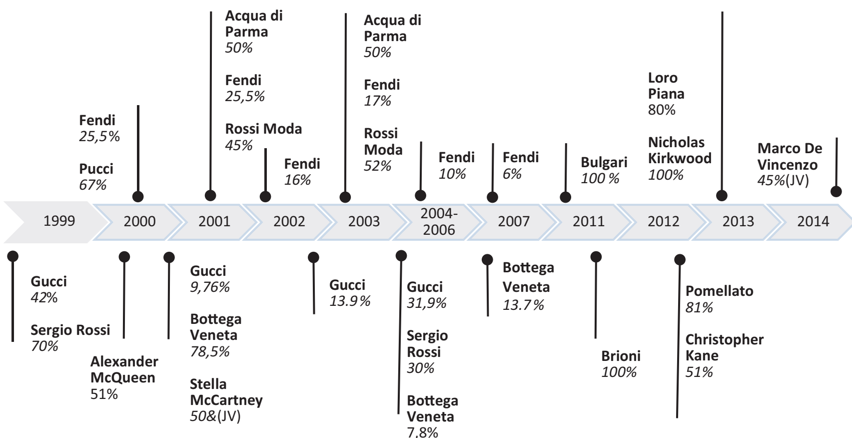


**Fig. 14.1** Chronology of M&A deals, managed by LVMH and Kering 1999–2014 in Italy (*Source:* based on Castello, M. Report KPMG Advisory, 6° Luxury Summit, Milano 2014. Note: Data from corporate reports)

Within the fashion and luxury market are also the Italian groups such as the Prada group, Luxottica and OTB. Prada group, directed by the CEO Patrizio Bertelli, is able to position itself, through the perception of buyers, on one of the highest positions in terms of production quality. Particularly, the creation of leather accessories, shoes and bags that since 1913, the date of opening of the first retail point by its founder Mario Prada, are synonymous with high-quality production and materials. The Prada group's business model is based on a total coverage of the value chain, from production to distribution, achieving competitive advantage and increasing revenues.

Through different brands' control—that is, Prada, Miu Miu, Church's, Car Shoe, Luna Rossa—which provide a portfolio of products defined as complementary, Prada group became a top global player. Finally, the expansion of the group had one last M&A task in October 2014 with the acquisition of the tannery Tannerie Mégisserie Hervy, located in Isle, Limonges, France. The new organization has the name Tannerie Limoges SAS. The operation aims to increase the traditional knowledge on the processing of lambskins and tassels.

OTB group was founded by the founder of the Diesel fashion house, namely, the president Renzo Rosso. Starting from the foundation of the Diesel brand in 1978, Renzo Rosso initiated major activities of

internationalization of its creative team, managing to position the image of the brand internationally. Thanks to the early success of the Diesel brand, in 2000 the organization began to undertake M&A, carrying within it a company named Staff International. In 2002, the year of acquisition of the Maison Martin Margiela Paris, Renzo Rosso gave life to the OTB group, named after by its vision and mission. In 2008 with the acquisition of the Viktor & Rolf brand, OTB, as happened for the Prada group, started to work for non-profit social purposes, creating the foundation OTB and promoting projects, such as through the restructuring of the Rialto Bridge in Venice in 2011. During 2011 and 2012, OTB proceeded with two other growth initiatives through the creation of the "kid" division with Brave Kid brand and the acquisition of the Marni fashion house.

The identification of these large competing groups within the fashion and luxury market, defines the structure of the latter in terms of M&A by organizational entities. Along with the operations of the latter, the world of M&A of fashion and luxury is also influenced by transactions by private equity entities and sovereign wealth funds. Examples of such operations are defined by the acquisitions by the Qatari investment fund of Italian fashion house Valentino, and the fashion house Bruno Magli by Swiss entity Private Equity Da Vinci Invest.

## The Scenario: The Role of M&A in Strategic Growth and the Development of Synergies

After identifying the large Italian and French players that have many advantages through the exploitation of synergies obtained through M&A, we show an overview of the economic data and operational choices defined by M&A within the fashion and luxury industry. Key reasons for M&A in the luxury industry are:

- Brand portfolio extension of luxury groups (69 % of total value, 52 % of deals).
- Financial investment (26 % of total value, 25 % of deals).
- Vertical integration (5 % of total value, 23 % of deals).

The strategic goal of M&A in this industry is an extension of brands/product/market, targets that are chosen for the creativity related to the brand identity.

The trade-off between level of integration and synergy potential is recognized in literature. Haspeslagh and Jemison (1991) in their framework identify three solutions: absorption refers to a high level of integration and low level of autonomy for the acquired company; preservation refers to the lowest level of integration and the highest autonomy for the acquired company; symbiosis combines synergy and differences. No integration approach fits all industries.

The literature on M&A underlines that not all acquisitions are alike. In the fashion industry, it is necessary to pay attention to managing the different critical differences in terms of degree of autonomy and integration.

How can synergies be realized in fashion and luxury serial acquisitions? Through acquisitions, large groups are aimed at streamlining the management of the individual brands by sharing common resources from administrative and accounting services to information systems, from legal advice to the bargaining power in the media advertising purchases (Cappellari 2016).

But there is a peculiarity in the luxury industry:

- Fashion and luxury is a creativity-intensive industry: it is both knowledge intensive and highly labour intensive.
- There is a high risk of losing the "creative soul".
- But, by forcing creative managers into an intensive knowledge sharing, there is a risk of changing and influencing them too much, losing the uniqueness and specificity of the corporate culture, impacting the brand identity.
- However, for developing markets, synergies are crucial economies of scale, as are knowledge sharing in commercial and marketing functions.

The main question is how to manage symbiosis in creative-based industries, where recognizing the importance of the autonomy of designers and taking into account cultural considerations are fundamental for the M&A performance. The choice of the appropriate integration approach should lead to effective integration of functions, capability transfer and so on.

Ranft and Lord (2002) argue that different units of the target firm might be integrated to different degrees, thus suggesting that integration

strategies based on autonomy vs absorption can coexist (Graebner 2004). The integration depth is one of the most central issue in fashion M&A.

Organizational arrangements and highlights have to recognize the target identity, but at the same time have to integrate to create synergies. However, if the management of the acquired firm retains full autonomy and the acquired firm is not integrated, synergy is not exploited. Nevertheless, autonomy removal may have a negative effect, above all if the acquirer and the acquired are culturally different. This dilemma can be an important factor in M&A success. This approach results in a full integration in the functions of marketing and sales, and greater autonomy given to the creative teams and production function. As for production, the almost artisanal knowledge on the production processes of luxury goods requires that this function retains a great deal of autonomy. Instead, one of the main advantages of being part of a multinational is the support for development of a strategy of opening flagship stores, a strategy that requires skills not widely used on the market, relationships with real estate owners and, above all, access to significant financial resources (Pinault 2014).

### Case Study 1: Bottega Veneta/Kering

Bottega Veneta was acquired in 2001 by Gucci group (now Kering). Revenues rose from €160 million to €1,106 million in 2013 with the creation of 2,000 jobs in eight years. They have a multi-brand strategy behind the construction of important synergies on the production side. The production of leather accessories and shoes sold under various brand names is centralized, and similar centralization was also launched on the different lines of watches (YSL, Boucheron, Bedat & Co) sold by the company. The firm uses a network of subcontractors for the manufacture of a large part of their products. But for Bottega Veneta, Kering uses a different integration approach: the value creation of Bottega Veneta's acquisition is based on his unique craftsmanship, so with the arrival of a new stylist, Thomas Maier, it was decided to preserve the production in Vicenza. Bottega Veneta maintains a high degree of autonomy on the creative side and the Kering group is committed to maintaining the independence of the team that deals with the product design, without trying to generate synergies between other lines and other brands.

The integration model has provided a full integration of the sales and marketing functions with large cost synergies and revenue, while the functions of manufacturing and some of the creative units have remained independent to preserve the artisanal knowhow of the company.

There are similar studies on research and development (R&D) firms (Bower 2001) and in the biotech industry (Tarba, Weber 2011), but in these industries knowledge transfer is a lever to increase research capabilities. In the fashion industry, instead there is a risk that an intense knowledge sharing leads to too much influence of the creative team and the potential for "too much" similarity in style and creations of new collections to those of other brands of the group. Especially considering that in fashion the acquirers are a few large global groups. The symbiotic integration approach emerges like an ideal type, but decision making on what to integrate and the attention paid to the speed of integration seems to be a fundamental key to better M&A performance.

## Integration Dilemma in the Fashion and Luxury Industry

In the fashion and luxury industry it is important to choose how much has to be integrated; and a central dilemma is the decision about whether to integrate the newly acquired organization and what degree of autonomy should be granted to the acquired management. The creativity is one of the attractive elements for an acquirer company that undertakes an M&A deal in the fashion industry. There are specific high risks when it comes to bad management of integration management post M&A: for example, the departure of key creative talents, loss of expertise and clash of corporate cultures (Weber, Tarba 2012). In many situations, the loss of autonomy that can result from the integration process can be detrimental to the performance of the M&A deal (Weber et al. 2011).

There are many analyses from financial and strategic perspectives, but few are contributions on value creation after the deal, analysing the integration of structures and processes as predictors of M&A performance. How can acquirers avoid problems and increase the chances of success? As already mentioned, failure is often due to an inappropriate post-merger integration strategy.

The M&A performance depends on the integration process. As mentioned at the beginning of the chapter, in creative-intensive industries like the fashion industry many studies examine two main dimensions when it

comes to improving organizational performance: knowledge sharing and employee retention (Ahmmad et al. 2012; Buchholtz et al. 2003). In the fashion and luxury industry losing creative talents presents a high risk, but submitting creative talents to an intensive knowledge sharing with the acquirer poses the risk of changing and influencing them too much. In this case, there is a danger of losing the designers' uniqueness, and with it the target company's identity. To avoid the homogenization of the creative visions of the different companies in the same group, it can be interesting to choose an ambidextrous approach, tighter and more replicative on commercial and marketing functions, looser and more path-dependent on production and creative functions.

The critical dimensions for developing synergies are knowledge sharing and employee retention, and choices about integration depth (what and how to integrate).

Our framework outlines how creativity and knowledge of production crafts can be important for retaining the most talented employee, and a higher level of integration can be reached by sharing the knowledge in a managerial field, for developing synergies to exploit and improving the organizational performance.

**Case Study 2: The Slow Integration of an Italian Fashion Company with a Multinational Luxury Goods Company**

An interesting and successful case to understand the development of synergies is the slow integration of an Italian fashion company known for its monogrammed handbags and leather goods made by a big luxury goods company, which is emblematic of the approach to post merger integration in this industry. The acquired company was a family-owned business and, at the beginning of the acquisition, the family maintained the management role.

Although the company management was very traditional and somewhat inefficient, for some years the only functions that were changed were the commercial ones: in two years the acquired company has expanded to more than 80 directly-managed stores around the world from two when the acquirer company first bought their stake. The aim was to preserve the uniqueness of the brand and the products.

(*continued*)

**case study 2 (**continued**)**

This is why the decision was taken to keep relevant people where there were specific, difficult to find skills that made up the DNA of the company: product development and production. Only three years after the acquisition, a CEO from outside was named, accelerating the integration through the design of product divisions and the establishment of new departments, in particular financial control. Even then, the members of the family who were not aligned with the new course were only slowly encouraged to leave, continuing to grow the number of professional managers and completing the management turnover in a more “rapid” way. The fine tuning of integration took place with a new CEO who consolidated roles and responsibilities of divisions and led the company into a profitable economic situation.

Today the company is a gem in the portfolio of this luxury multinational company: the final organizational design is a complete absorption of all business functions and a great autonomy of the core creative unit, led by a family member of the acquired company.

## The Role of Human Resource Management

M&A performance is influenced by different variables related to different dimensions such as strategic, financial and contextual, and defined by activities and projects disbursed throughout the M&A integration process (Weber et al. 2011). Related to a serial acquisition scenario, the results of human resource (HR) management activities are crucial, because of the diversity of the different companies acquired. Through an ambidextrous approach, the HR management has to focus on an ambidextrous management of the critical dimensions of knowledge sharing and employee retention: tighter and replicative on commercial and marketing functions, looser and path-dependent on production and creative functions. M&A performance can be improved by managerial market and commercial knowledge sharing, and retention of highly creative employees who know the raw materials very well. The main purpose of this approach is to avoid the homogenization of the different creative styles of different companies that belong to the group. The final purpose of this ambidextrous management is to develop synergies that will create and exploit competitive advantage.

The critical dimension of knowledge sharing is very important for improving value following the merger of different organizations. In the fashion industry, the ability to read and interpret the global market and to be able to take advantage of the commercial synergies in several countries become a source of competitive advantage in the end. The acquirers serially accumulate over time a significant expertise in these areas.

The HR function, through learning and development practices and projects disbursed, can help to increase the level of knowledge sharing among the organizational population. By involving the people in technical and managerial, or simply behavioural, learning projects, the HR function allows the increase of knowledge sharing.

In the fashion industry, the integration process post M&A tightly focuses on managerial business, such as markets and commercials, leaving out the creative part of the organization acquired.

HR practices contribute to determining the realization of synergies, but not all the companies are integrated in the same way and the integration approaches influence M&A performance, in relationship with the industry context.

The knowledge sharing results in one of the most important dimensions for increasing the organizational performance, because sharing and transferring business and process expertise involve decreasing weaknesses, delays and wastes, therefore improving organizational efficiency. Thus, is possible to state that the increase of knowledge sharing directly impacts the development of synergies to exploit for creating competitive advantages.

Art directors totally define the creativeness of the acquired companies. These people, at the same time, define one of the M&A's goals reached by the acquiring companies. Managing the key people gives the acquiring company greater possibility of retaining them in the group. If they keep working for the group, the creative people enable the head of the group to maximize on the synergies developed, creating advantages in the fashion world market. Thus, it is possible to state that the increase of employee retention directly impacts the development of synergies to exploit for creating competitive advantages.

Becoming a serial M&A organization requires not only great accumulation of resources but also building of specific knowledge. The integration process is therefore managed in an ambidextrous way. As already mentioned, people and organizational units have to be managed in different ways, because the management practices and the objectives are different too. On the one hand, the group has to retain the creative employees, to decrease the possible feeling of threat. On the other hand, serial acquirers have the need to develop the organizational processes of the acquired companies, to increase the efficiency, sharing and transfer of knowledge about markets, ICT systems and other tools.

### Case Study 3: The HR Management in the Only the Brave Acquisitions

Only the Brave (OTB) group is the parent company of some of the most iconic fashion brands, including Diesel, Maison Margiela, Marni, Viktor&Rolf and Staff International (manufacturer and distributor of DSquared,[2] Just Cavalli, Vivienne Westwood and Marc Jacobs Men).

With the exception of Diesel (the original brand), other brands and firms were acquired by OTB from 2000 to 2012. The acquisitions by OTB group have widely been considered financially and artistically successful on mutual levels.

Many of the acquired designers have acknowledged OTB for how it has respected their creative free knowledge-sharing results: one of the most important dimensions for increasing organizational performance because sharing and transferring business and process know how involve decreasing weaknesses, delays and wastes, hence improving the organizational process efficiency.

To promote knowledge sharing the HR function implemented many kinds of projects, such as learning room, team mobility and communication tools, especially in commercial units. Thus, it is possible to state that the activities and projects delivered by HR function have a positive impact on improving the knowledge-sharing level.

OTB has the need to retain creative employees. Group management is used to thinking that respect and preservation is the first employee retention practice to implement. With respect and preservation comes the acknowledgement of the high value of the creative team, and, consequently, the group management does not insert newly hired people into a creative team. This ensures the uniqueness of the acquired brand vision and style.

## Conclusions

The chapter has proposed a model that underlines features of the fashion and luxury post-merger integration approach. This symbiotic type of integration approach, the level of integration of different departments and the gradualness of integration, is shown to be preferred by successful and expert serial acquirers and is demonstrated to be more effective than other M&A integration approaches.

The importance of the mix of knowledge and labour-intensive features for the fashion and luxury industry clarifies the assumption of the focal value of HR that involves the knowledge and competencies during the stages of the M&A process in fashion companies. While the integration process aims to improve performance based on the potential of commercial synergies, it is important to monitor the human side of the acquisition to avoid destroying the value of the acquired company, which is embedded in the corporate culture and identity.

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# 15

# International Retailing and Growth Paths

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Retail is a crucial area for managing the luxury business, in terms of visibility, interaction with the customer, and concrete experience of the brand. It is also in continuous evolution, hence it is necessary to observe carefully what happens in order to be prepared and select the most appropriate approach.

*What makes it luxury* is not the material content alone nor the brand by itself: today's luxury market is dominated by the concept of experience.

Indeed, any market expert would agree that neither exceptional material characteristics of the product nor the presence of a famous brand would be enough for securing a luxury positioning if these excellences are not constantly translated into an experience. The essence of a *luxury experience*

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does not coincide with the material possession of a product, nor is it limited to intangible aspects or personal perceptions and feelings. It is a complex alchemy made of several different elements, continuously changing as luxury consumers—especially in mature markets—are continuously moving their search for satisfaction towards something more elaborate, more private and sometimes even far from conventional comforts.

And, beyond the multiplying social occasions of contact with luxury brands and products, the place where the experience mostly takes place is the store—either physical or virtual. Hence, it is crucial to accurately plan everything that has to do with the store experience, which is definitively not limited only to an excellent visual merchandising.

The store, indeed, is—on the one side—the privileged contact point with the customer, where he or she can experience the product/brand with all the senses, and—on the other side —the final stage of the supply chain, where products and services have to be delivered perfectly in line with the targets set by the critical success factors (CSFs) of the brand.

Hence, clearly, it is of paramount importance to plan and operate the overall network of points of sale to ensure that the customer is involved in the appropriate brand experience. This means defining the *number and kind of stores*, the *geographical market* in which they operate and the *specific locations*, which actor operates each store (e.g., direct operated stores vs wholesale channel). In addition, it is worth understanding that the domain of "operations" does not end with delivering products to the retail stores but it is also necessary to properly manage "in store operations" in order to ensure the required superior shopping experience.

In this chapter the main concepts of retail strategy will be investigated by considering the reasons why retail is relevant for the luxury business and by exploring the configuration strategy as well as the main configurations adopted in the industry. Finally, the retail analysis will focus on two main challenges for the industry, thereby the internationalization and the interconnection among processes and more specifically within the supply chain.

## Relevance of Retail for Luxury Business

Retailing is mentioned by Chevalier and Gutsatz (2012) as one of the oldest professions in the world. However, this is not sufficient to

demonstrate the importance of retail in general, and more specifically to the luxury industry. Nueno and Quelch (1998) raised four key management areas as the basis for brand success in the luxury market:

- *Design and communication management*: the paramount importance of creativity differentiates luxury from other business fields. Proposing a collection coherent with the desired style involves several actors, including retail (especially, but not only, in terms of store design). Thinking about the main *flagship stores* worldwide is a good example of how the design of the product is translated into the design of the store as well.
- *Product line management*: this has to do with offering the right product variety and innovation and facing the related costs. Furthermore, it involves choices regarding the marketing mix in different retail channels.
- *Service management*: as sales expand, luxury companies must become experts in customer service, relationship building and database management. Customer service in the luxury business often means fulfilling special requirements: craftsmanship and customization, for example, at custom shoemakers. Also sustaining the exclusivity generated by product rarity is very important, despite product assortment must be ensured in stores. Exclusive services must be formalized and provided, information systems must be set and used accordingly.
- *Channel management*: selective or exclusive distribution is one way of creating exclusivity. But the path to exclusive distribution must pass through several steps and different store formats; defining the structure of the retail network and operating the stores are two key activities for success in the luxury market.

All the quoted management areas are strictly connected with retail, and allow clear understanding of the strategic relevance of managing retail appropriately as a direct contact point with end consumers.

Furthermore, retail expansion (both physical and virtual) worldwide is a “hot” issue for the luxury business: that is, identifying the correct size of the distribution network as well as its composition, extending distribution to smaller cities, attracting new customer segments, following the customers as they travel, building prestige and establishing brand image, displaying full assortment, and managing the “omni-channel” context.

## Retail Configuration Strategy

Sometimes it is thought that a retail configuration strategy is not required for luxury companies, given that luxury companies are willing to use just their own stores. Actually, only a very small number of brands follow this approach. One of the most famous examples is Louis Vuitton who sells exclusively in its company-owned stores, excluding from the product range categories that are not consistent with this strategy. In reality, most of the companies are required to implement a mixed strategy (direct operated retail + wholesale), by combining different formats in different areas, for different product lines and for brands with different positioning.

As the retail stage is nowadays crucial for competing in the luxury market, it is important to identify what makes up a retail strategy and what the configuration is for luxury companies.

Retail strategy should be the basis for creating the "superior shopping experience" required by luxury consumers; hence, it is necessary to translate it into effective retail operations.

Thereby, managing a network of points of sale is a complex task, which requires—first of all—physically establishing the network of points of sale. This can be considered the "strategic" side of retail management, where most of the long-term decisions are made; indeed, the configuration of the network of points of sale creates the basic element for offering the exceptional shopping experience required by luxury consumers.

Taking into account the existing literature dealing with retail, five major dimensions that drive the configuration of a retail network can be identified:

- Several authors have addressed the *horizontal structure* (e.g., Newman and Cullen 2002), i.e., the *number of points of sale* for the considered luxury brand, as a relevant dimension for a firm's retail strategy. Because the higher number of points of sale, the higher capillarity of distribution (i.e., consumers have easier access to the brand's products), and so it is clearly linked to the concept of product and brand "accessibility". Of course, this term can be related also to the possibility of buying in economic terms: given the relevance of this aspect in the luxury market (i.e., what is "exclusive" should not be "accessible"), the correlation between physical and economic accessibility will be evaluated.

- A further relevant element related to the horizontal structure is the *retail format* (e.g., Dazinger 2005). Many different formats (e.g., flagship stores, monobrand stores, multi-brand stores, department stores, online stores, etc.) are used and both academics and practitioners recognize that the choice of store format is a crucial one.
- Another relevant element pertains to *market* (e.g., Moore et al. 2004), because internationalization is a fundamental dimension of a retail strategy. The globalization pursued by luxury companies actually confirms the relevance of setting the brand's presence into different countries, in an expansion that goes from mature markets (e.g., Europe and the USA), to growing markets (e.g., China), to emerging markets (e.g., India and Brazil).
- Besides, a key variable totally specific to luxury companies is the *location* (e.g., Fernie et al. 1997), because presence in a particular country is not the only geographical issue. The choice of a particular location within the country (e.g., capital cities vs small towns) and within the town (e.g., central locations vs peripheral ones) are crucial choices. Fifth Avenue in New York, Causeway Bay in Hong Kong, Champs-Elysees in Paris, Monte Napoleone in Milan or Stoleshnikov in Moscow are just a few examples of key locations of upmost relevance for luxury brands.
- Finally, "ownership" (e.g., Moore and Fernie 2004) of the retail channel (or at least of the point of sale) is a relevant aspect, as far as many luxury brands are increasingly pursuing the control of their sales network. Several possibilities are available, from completely independent stores (i.e., pure wholesale), to partnership situations (e.g., franchises), from corners in department stores, to flagship stores.

But the model presented above has mainly focused just on the structure of the retail networks. However, the structure is a fundamental element, but it is not enough. In this vein, one of the most famous models for analysing the retail network and raising some soft and hard skills is the one proposed by Pal and Byrom (2003). This model summarizes the main key points to tackle: *stock*—for assuring the required service level to customers; *staff*—for transferring to customers values and features of the brand; *space*—for managing available space in the most profitable

and consistent way; *systems*—for assuring the necessary IT support; and *standard*—for guaranteeing the coherence with guidelines defined centrally or locally.

## Retail Formats: Main Available Choices

Retail formats represent a major focus for creating the correct luxury experience; hence, among the five strategic dimensions quoted in the previous section, format deserves to be looked into further (Chevalier and Gutsatz 2012).

In today's luxury market, especially in its fashion-sensitive sectors, the *monobrand store* is largely the most common choice; many customers prefer to shop in this context due to its intrinsic correspondence with the brand essence. This (coincidence between the store and the brand experience in the consumers' mind) is the reason why it is of paramount importance to carefully plan any detail of a monobrand store, whether it is company owned or operated in partnership.

However, "monobrand stores" still represents a category that has to be further segmented (not exhaustively: e.g., Castelli and Brun 2010; Moore et al. 2000; Nueno and Quelch 1998) into:

- *Flagship stores*: the name is self-explanatory, these stores are the official presentation of the brand, where the original shopping experience takes place. They normally are located in the origin town of the brand, plus some "must have" locations such as New York, Paris, London, Milan, Tokyo and Shanghai. They are typically larger than all the other monobrand stores and often include "special features" (e.g., the brand's museum, dedicated collections, a coffee area, etc.). Variations on the theme (e.g., Prada's "anti-flagship") were conceived across the years.
- *Freestanding monobrand stores* (either directly operated or franchised): the most common, they are present in the majority of shopping towns and reproduce the experience originally designed for flagship stores; typically, while flagships present the whole collection range including "special items", the other stores simply present the central range, i.e., that aimed at achieving reasonable selling volumes.

- *Shop-in-shop* in department stores or wholesale stores: sometimes, a zone in a multi-brand context is presented as if it were a monobrand store; there are typically three sides (re-creating the idea of a separate store) with a sort of door or entrance that delimitates the area.
- *Counter* in a department store or wholesale store: a location given to the brand but operated by the department store; in contrast to the shop-in-shop, this area is not clearly separated from the rest of the store.
- *Corners* in department stores or wholesale stores: the same idea of a shop-in-shop, but physically open to the open floor of the store. Actually, it's half-way between a shop-in-shop and a counter.
- *Factory outlets*: the channel dedicated to discount sales (e.g., previous seasons, second choices, etc.). They are typically located close to the factories or in dedicated outlet shopping malls.

The counterparts to monobrand stores are multi-brand ones (e.g., Abecassis-Moedas 2006; Castelli and Brun 2010; Sen 2008). Two main categories can be identified, namely department stores and independent wholesalers:

- *Department stores* (e.g., Harrod's, Macy's, La Rinascente, Galeries Lafayette, etc.) are large shopping locations (typically they occupy a whole building) that offer a very wide range of product types, organized in product-focused areas. They are, in some countries such as the USA or Japan, the major channel for selling luxury products; this is especially true for partcualr product categories such as perfumes and cosmetics.
- *Independent wholesale stores* are, instead, typically smaller than department stores. Mostly, they base their success on choosing a certain brand's range and picking the right items that will sell well in the season. Sometimes independent wholesale stores are developed by particularly creative personalities who are so influent in the fashion sector that the store becomes a sort of "brand" and a destination itself: this is the case with *concept stores* such as Colette (Paris) or Corso Como 10 (Milan), so famous that they deserve the creation of special collections by famous designers.

Something that is becoming more and more important is *travel retail* (e.g., Chevalier and Gutsatz 2012). Travel retail outlets are a further declination of either monobrand or (more often) multi-brand stores, characterized by being located in airports. These are strategic configurations, as many people actually buy luxury goods while travelling: hence, it is crucial to make products available in airports or on cruise ships.

Finally, recent years have seen the rising of *online retail* (e.g., Sacerdote 2006). Indeed, the online channel actually reproduces a pattern similar to the physical stores: we have both monobrand and multi-brand online stores. In the past, this channel was perceived as totally unusable for luxury companies, but now is becoming a key asset of success. Burberry is a paramount example of a company that in the past used the electronic channel as a strategic lever for creating customer awareness and assuring a good fit between customers' expectations and brand features.

However, what makes the difference—beyond the higher accessibility of information, which produced the trends of *showrooming* and *webrooming*—is the difficulty of ensuring the coherence of offer and experience both in the online and offline channels: this is the challenge of "multichannel" or "omnichannel" retail, one of the hottest issues for luxury retail strategy.

## Retail at the International Level

The luxury industry is definitively an international area of competition: since the 1990s the industry has strongly increased its level of globalization. The economic crisis of the last years has just fostered this phenomenon: the success of international companies on the one hand and the sufferance of local and traditional companies on the other hand are two examples of the relevance of the phenomenon.

The value of internationalization is also confirmed by numbers, for example, by looking at the growing demand of luxury products in emerging countries, with predominant attention to experiential luxury over traditional, as shown in Table 15.1.

However, the internationalization—and more specifically the internationalization in emerging markets—to sustain the growth of the

**Table 15.1** Growth of luxury demand

| Country | Average annual growth of experiential luxury (2009–2011) (%) | Average annual growth of demand of luxury products (2009–2011) (%) |
|---|---|---|
| China | +28 | +22 |
| Brazil, Russia, India | +27 | +19 |
| USA | +9 | +6 |
| Europe | +6 | +4 |
| Japan | +6 | +1 |

Source of data: BCG Luxe Redux

company implies a comprehension of the specific characteristics of each foreign country.

Out of simplicity, we decided to focus attention on a subset of key countries for luxury companies, which are the most important traditional countries—USA, Japan and Middle East—and the main emerging countries—Brazil, Russia and China.

Each country has some specific features that might be more or less critical and that it is important to consider once companies operate internationally.

Main variables to bear in mind are the following (Caniato et al. 2013):

- *Climatic requirements*. Luxury companies would sell products worldwide, thereby covering countries in the counter-phase (e.g., Brazil and Australia for European brands) as well as facing different temperatures in different countries (e.g., high temperature in Middle East and India; very low temperature in Russia; three different temperature areas in China).
- *Season timing*. This variable describes the different duration of the sales period: for example, in USA sales period is shorter or in Japan is longer because there are not discount periods.
- *Economic potential of the country*. Not all of the countries have the same economic potential; some countries are very rich, such as the Middle East or Russia, and this could impact on the main choices in terms of retail strategy.

- *Religious requirements*. This variable measures the existence of specific religious requirements inside the country, which can impose modifications in the clothes (e.g., longer or baggier clothes in Muslim countries).
- *Stylistic requirements*. This variable measures the existence of some specific tastes of the country: for example, Russian women strongly appreciate red underwear, in the USA bags without zip are preferred, in China yellow is not really appreciated, etc.
- *Fitting or size*. Especially for fashion and clothing companies, it is fundamental to understand the features of the body shape: for example, in China and Japan the smaller sizes are required.
- *Geographical distance*. Luxury companies are willing to maintain an in depth control over their retail network: as far as possible, luxury companies would control the entire chain, very often through the adoption of own stores. Whereas the control over the country is much more difficult when the geographical distance is greater.
- *Regulation*. Different countries have different regulations, that luxury companies should definitively know and follow, also at the retail level. Customs, necessity of hiring national people and knowledge of local regulations are just a few examples of key elements to consider once a retail network is developed internationally.
- *Culture of the country*. Customers are the key actors to consider for a company, but especially when selecting the retail strategy. But not all countries have the same expectations, and so customers' needs are a key variable to consider. For example, a US customer would strongly appreciate the possibility of buying luxury products in key luxury malls.
- *Distribution network*. This variable is a big constraint that companies should follow: luxury companies should evaluate the existence of a good distribution network in the country in terms of presence of partners, for selecting the best pursuable option.

In Table 15.2, the main features of a selection of countries are presented in order to show which elements are critical for the specific country and which are simpler to handle. H represents very critical points to consider, M medium critical ones and finally L the ones that are not critical for retail network selection.

**Table 15.2** Relevance of country features for each country

| Country | Climatic requirements | Season timing | Economic potential | Religious requirements | Stylistic requirements | Fitting or size | Geographical distance | Regulation | Culture of the country | Distribution network |
|---|---|---|---|---|---|---|---|---|---|---|
| USA | L | H | L | L | M | H | M | L | M | L |
| Japan | L | L | L | L | L | H | H | H | M | L |
| Middle-East | M | L | H | H | H | L | L | M | M | L |
| Brazil | H | M | M | L | L | L | H | H | M | H |
| Russia | H | L | L | L | M | H | L | H | M | M |
| China | H | L | M | L | M | H | H | H | M | M |

As a matter of fact, this new competitive arena requires new managerial paradigms because operating at the international level is a totally different task compared to coping with the traditional market. Some managers have raised the adoption of the wrong configuration as one of the main causes of international failure. As they develop internationally, luxury companies will adopt different retailers: most companies use a mix of different retail strategies, in the same country sometimes or at least in different countries.

For this reason, based on the country features described in Table 15.2—but without forgetting the main characteristics of the company—each firm should identify the right distributional configuration to use in each country.

In particular, the main choices to consider once the company expands the configuration at the international level are the following (e.g., Castrogiovanni and Justis 1998; Fernie et al. 1997; Guy 1998; Vida and Fairhust 1998):

1. *Choice of the best retail network*. It is not mandatory to use the same structure adopted in the home country in all of the foreign countries. Some companies only have wholly owned stores in their home country, but are using franchisee stores or corners abroad. In the same way, companies are sometimes used to combining different models in the same countries for a period of time, for getting the maximum advantage and increasing the knowledge about the country. Perhaps the retail network is then revised after a certain period of time, when the knowledge about the country as well as the relevance of the country for the company in terms of turnover and brand image has increased.
2. *Choice of the best distribution partners*. Although luxury companies are willing to control as much as possible the distribution chain, in foreign countries it is very likely to receive support from external partners. In several cases, luxury companies might be supported by agents, who are people in charge of just selling products in different stores, to ensure in depth control worldwide. In other cases, a distributor or an importer are fundamental or are directly required by the retailers of the country. For example, several fashion companies are supported by Bosco dei Ciliegi in selling products in the Russian market. As it happens for the

retail network, it is very likely that luxury companies start gaining advantage through external parties but then decided to internalize these activities as well, perhaps through a sales subsidiary, after a certain period of time.

3. *Operational management of the foreign country*. Operating internationally is not just a matter of selection of the best stores, but also of guaranteeing the accurate service level and the accurate management of the chain. In this perspective, managers should also answer to questions such as: where is the best place to locate the stock? Is there any possibility of performing replenishment along the season? Are there some priorities in the deliveries worldwide?
4. *Selection of the right products for the right country*. All luxury customers are used to idea that they can buy exactly the same products worldwide. This is mainly true for some best sellers or for some brands that are willing to have the same image in all countries. On the other hand, luxury companies are very often obliged to understand which portion of their product range to deliver in each specific country. For example, not all products could be distributed in the Middle East, the same sizes could be sold in Russia and in China, the same colours are not appreciated in USA and Japan, etc. To ensure good management of the international business, these issues must also be tackled, without losing the tradition, the essence and the rules of the brand.

## Retail and Supply Chain Management

We started this chapter by mentioning that retail is not just the place where customers enter into contact with the company but also can be viewed as the final point of the supply chain. In fact, from a process-based perspective, the point of sale represents the last stage of the supply chain, that is, where the productive/logistic system finally reaches the consumers. And, despite retail being mostly studied from a marketing perspective, seeing it as "the other end of the supply chain" is more interesting as far as luxury/fashion companies are shifting from a push (supply-driven) approach to a pull (demand-driven) one.

The retailer is an integral part of the supply chain, for any product it sells; it is connected to the upstream stages through the distribution system that arranges for the shipment of the product from the manufacturer (or, more frequently, from warehouses or distribution centres) to the final consumer. However, much of modern retailing is not just the final link between producer and consumer, but also plays a dominant role in the supply process, as—in a demand-driven approach—this determines which volumes of which items have to be delivered in which points of the sales network, and when they are needed.

When brand has a paramount importance and some specific CSFs (e.g., exclusivity) are well defined for competing in the market, as it happens in the luxury business, the success of a retail channel depends on the company's ability to plan operations, vision and image of the store depending on both the brand(s) carried by the store and the specific target customers' requirements. And the supply chain behind the retail store has to function so as to satisfy the "service level" (e.g., delivery lead-time, punctuality of delivery, immediate availability) according to the retail channel requirements. For instance, the higher the store's identification with a brand (e.g., flagship stores), the higher the damage due to being out of stock of the current season "must-have" advertised items. The supply chain should be set up to replenish appropriately the stores with the "must-have" products, balancing the presence of high stocks at the point of sale with the logistics costs of frequent and quick deliveries from the central warehouses. Therefore, if availability for a certain product category (or a specific item) is a relevant source of value for the customers' segment targeted by that retail channel (also as a confirmation of brand's reliability), lead-time compression and flexibility through supply chain can be the keys for ensuring availability without keeping excessive stocks (which would be very expensive, especially considering the high value of luxury products). As a further impact in the upstream supply chain, domestic or close-to-market sourcing could be an option to consider in order to shorten end-to-end lead times.

In any market, retail offers to final consumers the following functions, each to be considered in its specificities compared to the CSFs of the luxury business (Newman and Cullen 2002):

- *Availability in an accessible location*. The value added by retailers is mainly allowing the customers to access the products, which otherwise they could not acquire. Making products accessible means, for instance, having them in the nearby store, or—as the recent trends showed—in large commercial malls, or through virtual online stores. When dealing with luxury, which has "exclusivity" as a major CSF, the typical question mark is: to what extent the retail location should be "accessible" without compromising the exclusivity aura?
- *Availability at the right time*. A good retailer will provide the products and services when customers require them. This means that planning the store assortment and the capacity for services is crucial; but also this can mean organizing the business to better meet customers' requests (e.g., extend opening hours). And, in the luxury business, where customers do not forgive even small service failures (excellence, both in product and service, is a must for claiming a luxury positioning!), availability at the right time is even more crucial than in other market segments. The relevance of the link with the supply chain is of upmost importance in that case. What if the season's "must-have" was not available in store? What if a custom item, with 18-months waiting list, had late delivery?
- *Availability in the right quantity*. Quantities of items in the retail store should be appropriate for customers' needs. In the luxury business this means managing the trade-off between rarity (which creates exclusivity) and volumes (for "must-have" items or aspirational/accessible positioning): planning the assortment and quantities in each point of the retail network becomes a strategic activity, that also needs a dynamic approach for adapting to the evolution of demand across the season.
- *Management of the information*. In the current environment, customers do not only look for the bare products, they often also want to get information about the product (e.g., how to use it, maintenance, how/where it is made, its ecological impact, etc.). In addition, customers provide—explicitly or implicitly—information about themselves and their purchasing behaviour. On the one hand, the retail store itself is a vehicle that communicates the brand's essence by means of design, space utilization, lighting (which includes, e.g., the attitude towards

sustainability issues). In addition, luxury consumers are everyday becoming more literate and require the store staff to provide all kinds of information about the items they could purchase. And not only storytelling about the brand—which is, anyway, essential; shop assistants must be ready to tell the story of products, details about manufacturing processes and locations, origin of the materials used, elements of uniqueness, matching styles to associate to the items, instructions for maintenance, etc. On the other hand, it is possible to collect huge amounts of data about customers' behaviour and preferences, so to continuously adapt the offer up to a customized approach.
- *Lifestyle support*. In case customers identify with a particular lifestyle (which is extremely common in the fashion/luxury market), the retailer has to guarantee that the shopping experience and the purchase are coherent and appropriate for the customer's lifestyle. Although this is partially subjective, a good retailer will constantly work in order to adapt his or her offering to the profiles of their customers. When dealing with luxury, it is essential to offer a shopping experience coherent with the brand's values and lifestyle; both the store design and any operations aspect must direct towards offering a coherent and exceptional experience; and the coherence should be ensured across the whole network and variety of channels (i.e., in an omni-channel perspective).

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