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LOUIS VUITTON[1]

Manu Mahbubani wrote this case under the supervision of Professor Mary Crossan solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

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SYNOPSIS

Moët Hennessy Louis Vuitton (LVMH) enjoyed double digit growth and healthy profitability in 2010 and 2011. A large part of this growth had been driven by its flagship group Louis Vuitton (LV). In 2011, LVMH announced that long-time LV CEO Yves Carcelle would be replaced at the end of 2012 by Jordi Constans, an executive from the French food product multinational Danone SA. However, after serving less than a month, Constans was replaced in December 2012 by Michael Burke, an LVMH insider who had been with the company for nearly 30 years. While LV had enjoyed rapid growth over the last two years, the question was whether such a growth rate was sustainable. What were the challenges facing LV, and how should these challenges be addressed?

HISTORY

Louis Vuitton Malletier was born in 1821 in Anchay, France. At age 16 he moved to Paris and took up a job as an apprentice trunk maker, over time becoming a respected trunk maker in his own right. In 1854, he opened his own company and over the next four years went about redesigning the trunk. In those early days, trunks were oval shaped and therefore not stackable; as such, they were not conducive to the emerging and rapidly growing forms of travel on steamers and trains. Vuitton came up with a flat-top trunk with flat hinges that was stackable and suitable for long journeys. A few years later, and in response to competitors copying his original design, Vuitton invented his famous trunk made of blue and red striped canvas.[2] The canvas protected the contents of the trunk from rain and dust, and customers loved the unique design. This innovation in material and design also made it difficult for competitors to copy. Vuitton's business thrived. He was able to cement his position among aristocracy in Europe and beyond, in places such as Egypt and India, when he was appointed the official packer and trunk maker for Eugenie de Montijo, Napoleon III`s wife and a Spanish countess. As a result, the business strengthened further.

[1] *This case has been written on the basis of published sources only. Consequently, the interpretation and perspectives presented in this case are not necessarily those of Louis Vuitton or any of its employees*
[2] *Dana Thomas, Deluxe, How Luxury Lost its Lustre, Penguin, London, 2007.*

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Vuitton's success is said to have been built on three rules: to master his *savoir faire*, to provide excellent service to his customers and to innovate continuously.[3] The newspaper *Le Figaro* in an article in 1889 wrote of Vuitton's fame:

> The Louis Vuitton firm, whose exclusive models are causing a sensation and must always be cited first, appears to have solved the problem of irreproachable manufacturing, of a ruggedness that withstands every test; it offers without a doubt the most beautiful specimens of French manufacturing.[4]

Georges Vuitton, Louis Vuitton's son, inherited the company after his father's death in 1892. Georges continued the company's focus on innovation. He invented the five number combination lock found on the trunks even today. He also designed the famous monogram pattern and the more complex pattern used on the canvas of LV products. Part of the motivation for these latter innovations was to counter the increased counterfeiting facing the company at that time.[5] Georges is also credited with designing hundreds of purses and moving the company into the handbag business. It was also during his tenure that LV started its global expansion. In 1893, LV displayed its products at the Chicago World Fair. In the years following, stores were opened internationally in New York, London, Alexandria and Buenos Aires.

The Second World War brought an end to this expansion. The period was marked by efforts of the Nazi occupiers to move the couture houses and luxury businesses from Paris to Berlin. Factories were closed and LV's international distribution contracts were terminated. After the war, the luxury business revived, but LV was not able to recapture its former position. By 1977, its revenues were only US$20 million and profitability low. It was under these circumstances that Renée Vuitton, the family's matriarch, brought in her son-in-law Henri Racamier to lead the business. Racamier had no background in luxury but was an astute businessman.

Racamier discovered that the majority of profits in the value chain were being retained by merchants. To bring these profits in-house, he started bypassing the merchants and opening company-owned stores. He also pushed for rapid global expansion, opening 95 stores by the mid-1980s. The LV brand was pushed aggressively, products were diversified, manufacturing expanded and new technologies introduced. Racamier also started acquiring companies that produced high quality products, such as Givenchy and the champagne house Veuve Clicquot. Revenues grew to nearly US$1 billion by 1987.[6] Racamier also took LV public and listed it on the French Bourse and the New York Stock Exchange. Going public allowed him access to capital, which was required to fund ongoing growth.

In 1987, as part of this strategy, Racamier agreed to a merger with Moët Hennessy, a company that was much larger than LV, to form the Moët Hennessy Louis Vuitton (LVMH) group. The companies had an agreement that each division would be run independently with its own management and philosophy, with Racamier maintaining his leadership position at LV. However, relationships between the two divisions deteriorated rapidly with disputes and legal battles over how to run the company. Finally, in 1987, Racamier brought in a property developer, Bernard Arnault, to bolster his position against Moët-Hennessy and try to reverse the merger. It was a move that Racamier would come to regret. Arnault had different plans, and those plans did not include Racamier.

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[3] *Ibid.*
[4] *Pamela Golbin, Louis Vuitton/ Marc Jacobs, Rizzoli ; Enfield : Publishers Group UK [distributor], New York, 2012 p. 27.*
[5] *http://voices.yahoo.com/louis-vuitton-history-behind-purse-53285.html, accessed September 11, 2011.*
[6] *http://www.fundinguniverse.com/company-histories/lvmh-mo%C3%ABt-hennessy-louis-vuitton-sa-history/, accessed September 11, 2011.*

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BERNARD ARNAULT

Bernard Arnault was ranked as the fourth richest man in the world by Forbes[7] in 2011 with much of his wealth being built on LVMH. Arnault was originally a property developer with no background in the tradition and heritage of the luxury industry. He entered the industry with the purchase of the then bankrupt French textile conglomerate Boussac Saint-Frères, for US$80 million; its holdings included the couture house Dior.[8] It was this latter holding, which provided him with a base to establish a luxury goods powerhouse, that Arnault was interested in. He brought his reputation for laser-like focus on profitability and efficiency to the acquisition. The French press dubbed him "the terminator." Fired executives would complain about learning of their dismissal from the press. Over the next few years, Arnault laid off over 8,000 employees and sold off large parts of the conglomerate for US$500 million.[9] He grew Dior into a profitable business using methods of vertical integration similar to those employed by Racamier.

When Arnault was approached by Racamier to help the latter bolster his position against the Moët and Hennessy families, rather than backing him Arnault quickly acquired a 45 per cent controlling stake in LVMH and garnered support from the Moët and Hennessy families. An 18-month legal battle for control of LVMH commenced between Arnault and Racamier, resulting in a victory for Arnault and the resignation of Racamier. Arnault became the CEO of the company, and control of LV slipped away from the Vuitton family. The stealth by which Arnault was able to acquire a controlling stake in LVMH and the level of bitterness and Machiavellian behaviour for control ultimately contributed to the rewriting of French laws around takeovers.[10]

THE PERSONAL LUXURY GOODS INDUSTRY

LVMH competed in the global personal luxury goods industry. This industry was projected to have revenues of €212 billion in 2012[11] and included products such as apparel, perfumes, cosmetics, shoes, leather goods and hard luxury goods. Leather goods included products such as handbags and accessories, while hard luxury goods included watches and jewellery. The global personal luxury goods industry was a subset of the larger €1.1 trillion global luxury industry that included a wide range of products and services from shoes and clothes to yachts and travel experiences.[12]

The growth rate for the personal luxury good industry for 2012 was projected to be 10 per cent in euro terms. However, since most of the major players in the industry were based in Europe, the euro exchange rate had a significant impact on nominal growth rates. For example, in 2012, the growth rate in constant exchange rate terms was expected to be 5 per cent. In 2011, the market had grown by 11 per cent in euro terms and 13 per cent at constant exchange rates, while in 2010, it had grown by 13 per cent in euro terms and 8 per cent at constant exchange rates. By 2015, the luxury goods market was expected to grow, at constant exchange rates, to €250 billion with a compound annual growth rate (CAGR) of between 4 per cent and 6 per cent. Of the various product lines, leather goods and shoes were growing the fastest, and by 2011 these formed the largest product segments. They had grown by an average of 15 per cent over the

[7] *http://www.forbes.com/profile/bernard-arnault/, accessed September 11, 2011.*
[8] *http://www.britannica.com/EBchecked/topic/35681/Bernard-Arnault, accessed September 11, 2011.*
[9] *Thomas, Deluxe.*
[10] *Ibid.*
[11] *http://www.bain.com/about/press/press-releases/bain-projects-global-luxury-goods-market-will-grow-ten-percent-in-2012.aspx, accessed February 3, 2013.*
[12] *http://www.ft.com/intl/cms/s/0/2cd3653e-ac0e-11e1-a8a0-00144feabdc0.html#axzz2JwtMxJt3, accessed September 17, 2012.*

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previous decade, and this growth was expected to continue into 2012. Growth, at constant exchange rates, was expected to be 16 per cent for leather goods and 13 per cent for shoes.[13]

The largest markets for luxury goods were in Europe and the United States, though the highest growth rate was in China, which had recently overtaken Japan in market size. Exhibit 1 breaks down revenues by region and shows the 2012 and 2013 growth rates that were projected for each region. Each of the regions, however, had different growth dynamics.

A fast growing and important region was the Greater China market, which included mainland China, Hong Kong and Macau, and had a total market size of €23 billion, 65 per cent of which was in mainland China. In 2011, the sales in mainland China had grown by 30 per cent, in euro and constant exchange rate terms. For 2012, growth was expected to decelerate to around 20 per cent in euro terms and 8 per cent in local currency terms.[14] However, these numbers underestimated the size of the Chinese market. By 2011, one in four worldwide luxury goods customers were Chinese. Wealthy customers from mainland China tended to travel widely. They therefore not only bought luxury goods at home but also did so during their travels. Such tourist shopping was fuelled by the differences across regions in prices of luxury goods and the risk of getting counterfeit products. For example, in 2011, prices in Europe were over 40 per cent cheaper than in mainland China, and these goods were perceived as less likely to be counterfeit when purchased in Europe. Indeed, over one-third of sales in Europe were made to Chinese tourists. In 2011, 60 per cent of sales in France were to tourists.[15] LV did make efforts to reduce such price disparity. For instance, in October 2012, the company increased European prices by 8 per cent.

Growth in Europe on the surface had been steady in 2011. But this masked an underlying weakening in demand as a result of the financial turmoil and austerity measures put in place by governments in southern Europe. There had, for example, been a significant drop in consumption of luxury goods in Italy. However, much of this decline had been offset by increased tourism and increased purchases by these tourists of luxury items. Growth in Europe, which had been 9 per cent in 2011, was expected to moderate to 5 per cent in 2012.[16]

In the Americas, growth was expected to remain strong as the United States continued its slow but gradual recovery from the 2008 recession. Growth rates were expected to rise to 13 per cent in 2012 compared to 10 per cent in 2011.[17] In Japan, while growth in euro terms was expected to be 8 per cent due to the rising yen, in constant exchange rate terms, the market was expected to be stagnant with either very low or no growth.

Customer Segments

The industry was split between three customer segments: absolute, aspirational and accessible.[18] At the top of the pyramid was the absolute segment that consisted of individuals of high and ultra-high net worth. These customers looked for true luxury, which was, in the words of Françoise Montenay, the president of Chanel Europe:

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[13] Claudia D'Arpizio, 2012 Luxury Goods Worldwide Market Study 11th Edition, Bain and Company, Milan, October 2012
[14] Ibid.
[15] Ibid.
[16] Ibid.
[17] Ibid.
[18] http://affaritaliani.libero.it/static/upload/bain/bain.pdf, accessed December 7, 2012.

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> At a minimum, it must be impeccable. Maximum, unique. It's the way you are spoken to, the way the product is presented, the way you are treated. Like the tea ceremony in Japan: the ritual, the respect, the transmission from generation to generation.[19]

These customers desired exclusive products backed by brands that were based on heritage and tradition. They generally bought the highest end of the product line in ready-to-wear products or bought made-to-measure products. These customers looked for excellent craftsmanship, the use of high-end materials and an excellent buying experience. They valued their privacy. Vendors set up private fitting areas, which could be salons or private apartments, for these customers to select their designs and to get measured and fitted. In some cases, vendors would fly a salesperson along with a collection to a buyer who might, for example, reside in China. The low-key nature of these purchases extended to the desire for the products not to carry logos that communicated ostentatious consumption. Price was an important factor, with true luxury expected to be priced at levels that most could not afford. In the words of a customer at Daslu, a high-end fashion store in Säu Paulo, Brazil:

> Luxury is not how much you can buy. Luxury is the knowledge about how to do it right, how to take the time to understand and choose well. Luxury is buying the *right thing.*[20] (emphasis in the original)

The second segment was the aspirational customer. These included the top 10 per cent of income earners such as celebrities, professionals and business men and women with high disposable incomes. High quality, an exclusive buying experience and brands based on tradition, heritage and that communicated the high quality of their purchases were important attributes for this group.

The final segment was the accessible customer who through the purchase of a luxury product experienced the feeling of having membership in an elite group. They got a taste of the world of the rich and famous. While these customers were more price conscious, the product they bought needed to convey a high level of quality and be backed by a brand that conveyed exclusivity.

In all three segments, customers valued products that were made in France or in other parts of Europe, more than those made in Asia or even the United States. The highest growth between 2012 and 2014 was expected to come from the top two segments of the market. By 2011, the absolute luxury segment made up 21 per cent of the overall market with growth rates expected to be above the market average with CAGR of 8 to 10 per cent between 2012 and 2014. The aspirational segment was expected to grow close to overall market rates with CAGR of 6 to 8 per cent during this period, while the accessible segment was expected to grow below the market rate.[21]

The behaviour of customer segments differed across markets. For example, in China as logo brands became more common, the absolute segment moved away from these brands since they were viewed as becoming less exclusive. Focus of this segment moved towards absolute luxury, which included high-end experience and service, and away from logo products. On the other hand, this issue was less prevalent in Japan where high luxury brands were heavily indulged in by all customer segments without undermining the attractiveness of the brand in any one segment.

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[19] *Thomas, Deluxe, p. 324.*
[20] *Ibid., p. 345.*
[21] *http://www.altagamma.it/img/sezione3/files/397_975_file.pdf, accessed December 7, 2012.*

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Changing demographics and global economic challenges had led to some changes in consumer buying behaviour. For example, customers, especially at the higher end of the market, had moved towards placing more value on luxury experiences, such as luxury travel and spas, than luxury purchases.[22]

Pricing and Distribution

The major companies in the industry tended to cater to all three segments. For example, PPR offered products through its Puma brand to the accessible customer segment, through the Gucci brand to the accessible and aspirational customer segments and through brands such as Bottega Veneta to the aspirational and absolute customer segments. Smaller competitors tended to focus on specific customer segments. For example, Hermès focused more on the higher end of the market by offering bespoke, higher quality and more expensive products. Prices charged by the companies varied according to the segment at which the product was targeted. Generally, lower prices for products targeted the accessible customer segment. Prices for a handbag would start at around US$3,000 for the absolute customer segment and could exceed US$100,000. They would start at around US$1,000 for the aspirational segment and around $300 for the accessible segment.[23]

The highest prices were reserved for limited edition products or bespoke, made-to-measure offerings. However, especially at the high end of the market, players tended to compete more through product design, the buying experience and brand image rather than through price. In general, companies had been able to command a high price for their products. In keeping with these dynamics, companies had tended to invest heavily in advertising to build their brands and in product design and development to deliver unique products. Distribution models also varied considerably with some players selling through resellers while others, such as LV and Hermès, relying on company-owned stores. Many of the more successful companies controlled most aspects of their production and distribution in order to ensure a level product quality and experience that justified high prices for their goods. In many cases, companies used multiple channels, including directly owned stores (DOS), department stores (termed wholesale) and licensing of their brands to third parties. Growth rates varied between the various channels. For example, in 2011, DOS sales had increased by 15 per cent in euro terms, and 9 per cent at constant exchange rates versus 10 per cent in euro terms for the wholesale channel. This trend was expected to continue in 2012. Similarly, sales in outlet stores that sold discounted merchandise had risen by 19 per cent at constant exchange rates in 2011 and were expected to rise by 20 per cent in 2012.[24]

Suppliers

Many of the companies, especially at the higher end of the market, designed and manufactured their products in-house. As such, they generally sourced only component parts, such as leather, zippers and clasps, from external suppliers. Companies were selective in their purchasing and had dedicated functions to ensure the supplies being purchased met the required quality standards. While the industry was dominated by a few large buyers, there was no such concentration on the side of the suppliers.

[22] https://www.bcgperspectives.com/content/articles/consumer_products_automotive_luxe_redux/?chapter=3, accessed September 24, 2012.
[23] http://www.pwc.com/it/it/publications/assets/docs/marketvision-luxury-2012.pdf, accessed December 7, 2012.
[24] Claudia D'Arpizio, 2012 Luxury Goods Worldwide Market Study 11th Edition, Bain and Company, Milan, October 2012 .

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THE LVMH GROUP

LVMH, Moët Hennessy Louis Vuitton, operated five businesses: wines and spirits, perfumes and cosmetics, fashion and leather goods, watches and jewellery and selective retailing. The group owned over 60 luxury brands.[25] In 2011, sales were €23.6 billion and profits were €3 billion. Exhibit 2 gives the financial details of LVMH group and three of its competitors for 2009 to 2011. The group had enjoyed substantial growth in revenue and profitability over this time period.

Acquisitions

While it had grown over the last two decades both through acquisitions and organically, acquisitions had played a major role. The majority of acquisitions had been in companies that produced high quality luxury products. Some of the major acquisitions included Givenchy (1998), Céline fashions (1996), the winery Château d'Yquem (1996), the retail distributor DFS (1996), the perfume chains Sephora (1997) and Marie-Jeanne Godard (1998), Miami Cruise Line Service (2000) which owned duty free shops and the designer clothing company Donna Karen International (2000). It also had stakes in multiple luxury goods companies including Fendi, numerous wine makers and brands such as Ole Henriksen and Nude Brands.[26] In 2011, LVMH closed a deal to acquire the jewellery and watch maker Bulgari. Bulgari was a large player in the industry with 2010 revenues of €1 billion, and its integration into LVMH was expected to require substantial attention from the LVMH executive team. Other than Bulgari, LVMH made one other acquisition and invested in two companies in 2011. In general, the rate of acquisitions made by LVMH had fallen over the last few years with greater emphasis placed on buying partial stakes in companies.

In 2010, LVMH quietly acquired 17 per cent of the outstanding shares of its competitor Hermès. Arnault purchased the shares through derivatives to circumvent the French law that requires a company to report more than a 5 per cent ownership interest. This ensured that he did not have to make his position public until a larger share had been acquired. Hermès was surprised by the move and did not accept Arnault's assurance that LVMH had no intention to acquire Hermès or seek a board seat. By 2011, LVMH's stake in Hermès had increased to over 22 per cent. To prevent a possible takeover, members of the Hermès family formed a holding company that controlled over 50 per cent of the company's shares. In 2012, Hermès filed a lawsuit against LVMH, claiming irregularities in the way LVMH had acquired its stake.

FASHION AND LEATHER GOODS GROUP

The Fashion and Leather Group had a number of brands under its umbrella that sold handbags and leather goods. These brands included Louis Vuitton, Loewe, Fendi, Marc Jacobs, and Donna Karan New York. These brands had operated in different customer segments. Louis Vuitton had positioned its products in the absolute and aspirational customer segments. Loewe had been situated at the absolute customer segments and at the higher end of the aspirational customer segments. Prices for its handbags had started at $1,500, though most had been priced at between $2,000 and $4,000. Loewe's high end handbags had been priced over $5,000 and they had emphasized their made-to-order offering, which had tended to be more expensive. Fendi and Marc Jacobs had offered products primarily to the aspirational customer segments. Handbags prices at Fendi had started at $600 though most handbags had been priced between

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[25] *http://www.lvmh.com/the-group/lvmh-group, accessed February 3, 2013.*

[26] *http://www.hoovers.com/company/LVMH_Mo%EBt_Hennessy_Louis_Vuitton_SA/crxfci-1-1njhxk.html, accessed September 12, 2012.*

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$800 and $2,500. The high-end handbags had been priced around $4,000. At Marc Jacobs prices had started at $800, most of the handbags had been priced between $1,000 and $2,500, and high-end handbags had been priced between $10,000 and $25,000, though the selection at this range had been limited. Donna Karan New York in contrast had served the accessible customer segment and had priced its handbags between $150 and $500. Details about Louis Vuitton's products and prices are provided in the next section.

The Fashion and Leather group's financials are given in Exhibit 3. Revenues for 2011 had grown in euro terms by 15 per cent and organic growth, in constant exchange rate, was 16 per cent. Revenues in 2010 had grown by 20 per cent in euro terms and 13 per cent in organic terms.[27] Revenues by region are provided in Exhibit 4.

Even though the group had multiple brands, the largest brand, the one that drove the financial performance of the group, had been Louis Vuitton. As such the financial performance of the Fashion and Leather group had been expected to largely mirror the performance of Louis Vuitton. In addition, decisions made by Louis Vuitton had a direct and substantial influence on the performance of the group.

LOUIS VUITTON

After taking control of LVMH, Arnault weeded out the old executives from LV and in 1990 brought in Yves Carcelle as CEO. Under the new leadership and in partnership with Marc Jacobs as head designer, LV flourished. Arnault and Carcelle brought attention to bear on the profitability and efficiency of the business. They continued the practice of selling only through company-owned stores, but they also made other changes. Unlike Racamier, under whose leadership 70 per cent of production was outsourced, the two brought production in-house, soon expanding the number of factories in France from five to 10. In 2004, they bought out distributors and took direct control of the distribution channel. According to Arnault "If you control your factories, you control your quality" and "If you control your distribution, you control your image."[28] In addition, in partnership with Marc Jacobs, an increased focus was put on new product designs and innovations that resulted in a slew of creative and successful products.

LV products included a wide range of luxury fashion goods for women and men including handbags, wallets, luggage, accessories, ready-to-wear clothes, shoes, watches and jewellery, though the company's mainstay, and what it was known for, was its collection of leather products. One area in which LV did not, in 2011, offer products was perfumes. This was an area into which the company was considering expanding. The perfume market stood at €19 billion in 2011[29] and was expected to grow by 5 per cent in 2012. The absolute and aspirational segment made up about 25 per cent of the market. Of note was that the parent organization, LVMH, had significant experience in the perfume products in its perfumes and cosmetics division. This division had industry leading brands such as Christian Dior, Guerlain and Givenchy under its umbrella.

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[27] *LVMH Annual Report, 2011*
[28] *Thomas, Deluxe, p. 52.*
[29] *Claudia D'Arpizio, 2012 Luxury Goods Worldwide Market Study 11th Edition, Bain and Company, Milan, October 2012.*

Pricing and Customer Segments

LV's product portfolio included offerings for all three segments but had primarily focused on the Absolute and Aspirational customer segments. Prices for handbags had varied from a low of US$300 for clutches to a range of mid-priced products priced between US$750 and US $3,500. At the high end, handbags had been priced anywhere from US$3,500 to US$35,000 with some handbags selling for US$100,000 or more. The higher end handbags had included custom designed bags that took five months to deliver. In many of its stores, an area used to be reserved for the best customer to shop in privacy. In some cities, LV had owned private apartments and yachts, which included amenities such as butler service, where customers would be given design consultations and could be fitted.

Prices had been tightly controlled. Products were never discounted or sold in value packs. LV, like many others in the industry, had considerable power to increase prices. While price increases had slowed after the 2008 recession, they started picking up in the second half of 2010. In 2010, prices in the euro zone were increased between 2 and 3 per cent. In 2011, prices were increased by 16 per cent in the United States, 5 per cent in Europe and 11 per cent in China.[30] Some of these price increases were made in response to currency fluctuations. Between the second quarters of 2011 and 2012, overall prices were increased by 7 per cent.[31] These price increases made up for the smaller price increases that had followed the 2008 recession. In the words of a senior executive interviewed for the magazine *The Economist*:

> There are four main elements to our business model — product, distribution, communication and price. Our job is to do such a fantastic job on the first three that people forget all about the fourth.[32]

However, while prices had increased in 2011, customers, especially those in the accessible and aspirational segments, were becoming value conscious. It was therefore expected that future price rises would be more moderate.

Distribution

As previously mentioned, LV sold most of its merchandise through its own stores. The number of stores had increased from 368 at the end of 2006 to 425 at the end of 2008. By the first quarter of 2010, the store network had increased to 451.[33] Fewer than 10 stores had been inaugurated in 2010, with the retail network totaling 458[34] stores by the end of the first quarter of 2011. These stores were located at prime venues in major cities. Stores in many of the cities were anchored by flagship stores; all stores were designed centrally at LV's main operations in France to communicate the company's French tradition and heritage as well as to provide a unique experience of opulence and luxury. Centralized control of the store designs allowed for a common brand image across them. Some had areas that were available to members only. Membership required recommendation by a current member, a one-time initiation fee and an annual membership fee. Per store, revenues were €12.7 million, more than double the per store revenue figures for Gucci and Prada.[35]

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[30] *Transcript from investor conference call on October 18, 2011.*
[31] *Transcript from investor conference call on July 26, 2012.*
[32] *The Economist, "The Substance of Style." September 17, 2009.*
[33] *Transcript from investor conference call on July 27, 2010.*
[34] *Transcript from investor conference call on July 26, 2011.*
[35] *http://www.businessweek.com/news/2011-11-16/vuitton-sees-growth-tied-to-invitation-only-luxury-salon-retail.html, accessed September 24, 2012.*

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During the opening of the Bond Street store in London, Jacobs commented: "I think it [Louis Vuitton] is one of the few companies . . . who have made that leap to create an alternative universe . . . another universe that co-exists with the classic universe that it is built on."[36]

Products were only sold through LV stores. Brands were not licensed to third parties. Excess stock was destroyed rather than discounted. Products were not sold through outlet stores or in value packs.

Tight control of distribution also ensured that LV products did not get "lost" during distribution to show up in the grey market. Another strategy used to counteract grey markets was to ensure that price differentials between markets were not high enough to encourage the creation of grey markets. For example, LV entered Japan when it discovered that third parties were bringing products that had been purchased in stores in Europe into the country and selling them at very high prices. The company set a formula whereby Japanese prices were set at 1.4 times the prices in France, a price point that was significantly lower than what third parties were selling at. More recently, despite difficult local economic conditions, the company increased prices in Europe because Chinese shoppers were buying in Europe rather than in China to take advantage of the high price differential partly caused by high import duties in China.

LV had also sold its products online. While it had been difficult to sustain an aura of exclusivity in the online marketplace, this channel had provided access to a larger customer base. Online products had been offered in markets such as the US, Europe, and Japan. They had however not been offered in China and other markets in Asia. Further, many of the higher end products, including the made-to-measure products, had not been sold through the online channel.

Manufacturing

LV manufactured all its products and did not buy products from third parties for resale. So, when it expanded its product portfolio to include shoes, it set up a shoe production facility in Italy. It operated 17 factories, of which 12 were located in France, three in Spain and two in the United States. Most of its production was done in-house, with only parts, such as zippers, being sourced externally. In 2011, it opened its newest factory in Marsaz, France. The factory expanded production by 70 people.[37] The new factory, which took over three years to bring into production, helped ease some of the product shortages that in 2010 had forced the company to reduce store hours in France. New employees at the factory were trained by experienced workers. Given the size of the company, the new factory could be considered a small increase in capacity. LV tried its hand at expanding manufacturing internationally. In 2007, it announced the setting up of a shoe factory in Pondicherry, India. However, in 2011, the plant closed due to labour trouble.

Improving Efficiency

LV had also focused on improving the efficiency of its production system through the introduction of manufacturing practices inspired by the lean production techniques used by Toyota Motors. The program, implementation of which was started in 2005, reduced the level of specialization of an employee and trained employees in multiple activities, thereby improving productivity. The manufacturing line was reorganized. Originally goods in production would be put on carts and wheeled to workers, resulting in

[36] *http://www.youtube.com/watch?v=jyp9QVQvPL4, accessed September 20, 2012.*
[37] *http://online.wsj.com/article/SB10001424052702303627104576409813842858304.html, accessed September 20, 2012.*

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goods staying a long time on carts. The new system organized workers in groups of six to 12, with the complete manufacturing of a product staying within the group. These changes not only increased production efficiency but also, since the workers were less specialized now, allowed the company to shift groups to manufacture different products in response to changes in demand. Increased automation, such as the use of robots, also helped improve efficiency. At its peak, efficiency was increased by 5 per cent per year, though a more sustainable rate was expected to be 3 per cent per year.

However, improved efficiency in manufacturing had some consequences. The LV brand projected its products as being handmade by artisans. Customers, especially those in the top two segments, expected their products to be unique and designed and crafted by artisans. Too much reliance on automated manufacturing processes could undermine the appeal of the brand to these customer segments. For example, in 2010, two of LV's ads were banned in the United Kingdom for implying that its bags were handcrafted while in reality they were machine stitched. As Yves Carcelle said in an interview with the *Wall Street Journal*: "Our paradox is how to grow without diluting our image."[38]

The focus on improving efficiency was also true for all other departments. For example, rather than a sales person going to the back room to pick up products and leaving the customer alone, an assistant would bring the products to the sales person. At checkout time, products would be packaged in the backroom and brought to the customer. Experienced sales persons therefore could concentrate on selling without interruption.

Product Design and Innovation

LV was known in the industry for having some of the top design and creative talent. Creative design and innovation in raw material and manufacturing processes were an important component in keeping ahead of the competition and providing customers with products that were viewed as unique. In an interview, some of LV's employees talked about what this involved:

> There is a connection between sophistication and expertise; …. For example, with the basket bag this season, it looks very simple, but actually it wasn't simple because it was two layers bonded together — a technique that was embossed and cut out and perforated at the same time. Before that we'd only done perforations, so we were challenging the production team to do [multiple techniques] at the same time. So there's always some way in which we are pushing new and innovative ways of working. . . .[39]
>
> The words they use at the factory are "We'll try!" . . . It's very rare. I don't think there was anything for the show they couldn't do. . . . We sit down and we work out how we can achieve what we need. I think that's the magic of being here.[40]

And specifically on leather goods:

> It's the heart of the business, it's the image of the business — leather goods are the core of the company. Working on the fashion leather goods was amazing training and experience…. How do you convey the message of Marc throughout the store network — how is that creativity communicated? I'm not just talking about an advert at the end of

[38] *Ibid.*
[39] *Golbin, Louis Vuitton/Marc Jacobs, p. 143.*
[40] *Ibid.,*

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> the line. It's about how to release things, how things are evolving creatively and implementing that within the business. If the bags are getting more sophisticated how do you speak about that? How do you treat the bags? So there's lots going on there.[41]

Quality

Part of making top quality products involved sourcing high quality materials. For example, for top-end products, leather was sourced from northern Europe since leather from cattle there had fewer blemishes from insect bites. Products were also put through rigorous testing to ensure quality. Some of the techniques used included a robot that repeatedly dropped a bag containing a three-and-a-half kilogram weight, a machine that opened and closed a zipper 5,000 times and another that shot ultraviolet rays at the bag to test for fading.[42] All products had a lifetime repair guarantee.

Competition

LVMH, the parent company of LV, was the largest player in the industry with 2011 sales of over €23 billion. Other large players included the conglomerates PPR and Richemont. PPR, headquartered in France, marketed a wide range of products from fashions and beauty care to home appliances. It owned brands such as Gucci and Puma. Sales in 2011 were over €12 billion with Gucci accounting for €3 billion of those sales. PPR also sold leather handbags and luggage. Its total sales of luxury goods in 2011 were nearly €5 billion. The other large player, Richemont, was based in Switzerland and also operated a wide range of businesses including jewellery, luxury watches, leather goods and apparel. Some of its brands included Cartier, Baume and Mercier, Montblanc and Piaget. Its sales in 2011 were nearly €9 billion.

Many of the companies, especially in Europe, were controlled by founding families who owned either a majority or a sizable minority position in the firm. This was true of larger players such as PPR, where the founding family controlled over 40 per cent of the outstanding shares, and of smaller companies such as Hermès, where the founding family controlled over 50 per cent of the outstanding shares. The companies were fiercely protective of their brands that in many cases were over 100 years old.

Brands that LV competed against were either owned by conglomerates, such as PPR, or by smaller companies such as Hermès or Prada. Exhibits 5 and 6 provide an overview of the main competitors and their sales distribution by region.

Details on each of competitors are provided below.

Hermès

Competition from Hermès came in the absolute and aspirational segments. Hermès prided itself on producing exclusive high quality goods that were produced by experienced craftsmen using the best material available. The company promoted itself as innovative and creative with the capability to design and produce unique products. Some of these products, such as Birkin handbags, had a waiting list that was months long. Prices for the Birkin bag started around US$5,000 and went up to five and six digits.

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[41] *Ibid., p. 139.*
[42] *http://www.businessweek.com/stories/2004-03-21/the-vuitton-money-machine, accessed September 20, 2012.*

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Most of the handbags were priced between US$2,000 and US$10,000, though many were priced higher.[43] The company produced some of the most expensive handbags in the world. In 2012, for example, Hermès released a handbag priced at US$2 million. In addition to this ready-made line of handbags, Hermès was also known for designing and manufacturing high-end handbags to customer specifications.

Hermès's range of products included leather goods, apparel, saddlery, silk products, shoes, accessories and fragrances, though 47 per cent of its sales came from leather goods.[44] Its products were sold worldwide through company-owned stores and through select retailers. In all cases, Hermès kept tight control of distribution and prices. Revenue breakdown by region, including growth rates, are given in Exhibit 6. Given its rapid growth, Hermès was expected to focus in 2012 on continuing to improve manufacturing capacity. Most of this manufacturing was located in France and emphasized traditional manufacturing practices rather than assembly line or mechanistic manufacturing processes.

Gucci

Gucci was part of the PPR group. It designed, manufactured, distributed and sold leather goods, ready-to-wear apparel, silks, timepieces, jewellery and fragrances. Its mission was to provide excellent products and experience for its customers based on heritage, craftsmanship, high quality and innovation backed by a "Made in Italy" label. In 2012, its handbag prices started in the US$850 range with most priced between US$1,000 and US$3,000. Some bags were priced as high as US$4,700.[45] Most of its products were manufactured in Italy and were largely sold through 376 DOS and some through department stores. The brand was making significant efforts to reduce distribution through resellers and also making efforts to limit merchandise offered at discount prices.

In 2011, Gucci achieved revenues of €3.14 billion and a recurring operating profit of €946 million. Revenues had grown by 18 per cent in euro terms and 19 per cent in constant exchange rate terms from the previous year.[46]

Bottega Veneta

Bottega Veneta was also part of the PPR group. Its revenues in 2011 were €683 million and recurring operating income was €205 million, up 33 per cent from the previous year in both euro and constant exchange rate terms. The majority of its products were leather goods, though it also sold shoes, ready-to-wear apparel and fragrances. Its brand was based on exclusivity, craftsmanship, the highest quality and innovation, also backed by a "Made in Italy" label. Products were sold through 170 DOS and through other retail channels such as select department stores and franchises. For 2011, sales from DOS had increased by 32 per cent and through the wholesale channel by 41 per cent.[47]

Prices for handbags started at US$1,400, with the upper end of the ready-to-wear collection priced at over US$28,000.[48]

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[43] *http://www.hermes.com/index-ca-en.html, accessed December 3, 2012.*
[44] *Hermes annual report, 2011.*
[45] *http://www.gucci.com/ca-en/home, accessed February 3, 2013.*
[46] *PPR Annual Report, 2011*
[47] *PPR Annual Report, 2011*
[48] *http://www.bottegaveneta.com/, accessed February 3, 2013.*

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Prada

The Prada Group was headquartered in Italy though its shares were listed on the Hong Kong Stock Exchange. In all, 19 per cent of Prada Group shares were publicly traded. The group owned a number of well-known brands anchored by its famous Prada and Miu Miu brands that covered mainly leather goods and shoes but also included accessories, jewellery and fragrances. The company's brands were based on heritage and craftsmanship, high quality and innovation. DOS accounted for 78 per cent of its sales while the rest came from wholesale channels that sold to select department stores across the world. Its goods were manufactured in-house with factories located in Italy and the United Kingdom.

Revenues in 2011 were €2.6 billion and net income was €436 million. Revenues had grown by 25 per cent over the previous year in euro terms and by 26 per cent in terms of constant exchange rates. Sales in the retail channel had increased by 37 per cent in 2011, while sales through the wholesale channel had declined approximately 5 per cent.[49]

Prada priced its bags starting at US$1,000, with most bags priced between US$1,500 and US$4,000. Bags at the high end went for between US$6,000 and US$10,000.

Chanel

Chanel S.A., established in the early 1900s, was a privately held fashion house headquartered in France. The company's products were wide-ranging including sunglasses, perfumes, skin-care products, ready-to-wear collections, handbags, shoes and accessories. It sold its products through company-owned stores and select department stores. In 2012, its accessories, including handbags and other leather products and apparel, were not sold online.

Since it was a privately held company, financial information was not publicly available. However, industry sources pegged Chanel's 2012 revenues at around €3 billion.[50] Other indicators provided a clue to Chanel's position in the marketplace *vis-à-vis* LV. An analysis of web searches indicated that the four most searched handbag brands online were LV, Chanel, Gucci and Hermès accounting for 30 per cent, 23 per cent, 13 per cent and 10 per cent respectively.[51] Chanel was also ranked higher than its competitors in terms of brand quality, customer experiences and social status by high income earners.[52]

Chanel priced its handbags starting at US$1,650, with most handbags priced between US$2,500 and US$5,000. High-end handbags were priced between US$6,000 and US$10,000.

Coach[53]

Coach was firmly entrenched in the accessible customer segment. Most of its handbags were priced between US$200 and US$600, with the most expensive ones priced around US$1,000. While Coach was not a direct competitor, it was an example of a company whose product price range overlapped with that

[49] *Prada Annual Report, 2011.*
[50] *http://www.businessoffashion.com/2012/10/ceo-talk-bruno-pavlovsky-president-of-fashion-chanel.html, accessed January 14, 2013.*
[51] *http://blogs.ft.com/material-world/2012/11/20/handbags-at-the-ready/?, accessed January 14, 2013.*
[52] *http://luxuryinstitute.com/blog/?tag=chanel, accessed January 14, 2013.*
[53] *Coach Annual Report, 2011*

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of LV. It was the type of company with which LV would have to compete if it decided to enter the accessible customer segment.

Coach's products were sold directly through company-owned stores, which included factory outlets, and indirectly through the wholesale channel via department stores. In North America, for example, Coach's products were sold through 354 company-owned retail stores, 180 factory stores and 990 third-party department stores. However, 81 per cent of its revenue came from the direct channel.

Coach outsourced its manufacturing with sourcing and product development offices located in Hong Kong, China, Vietnam, South Korea and India. Its manufacturing was sourced out of China, Philippines, Taiwan, Vietnam, Thailand, India, Peru, Italy and the United States. There was significant emphasis on product development with 71 per cent of 2011 revenue generated from products that did not exist a year earlier.

For the 12 months ending June 30, 2012, Coach had annual net sales of US$4.8 billion, with net income of US$1.04 billion. Revenues over the last 12 months had increased by 14 per cent and net income by 18 per cent.

THE DILEMMA

Reviewing the history of LV and its current performance, a number of concerns came to mind. While it was obvious that the company's performance in 2010 and 2011 had been good, were there early signs of trouble? Could the recent performance be sustained? What were the options available to Michael Burke?

Michael Burke was a veteran of LVMH who had been working with Bernard Arnault since 1986.[54] He had been widely credited for the turnaround of Fendi from a money-losing family business to a highly profitable brand.[55] In December 2011 he had been appointed as the CEO of Bulgari, a large and important acquisition made by LVMH. A year later, as he took over the helm of Louis Vuitton, some of the issues facing him were how should he balance the values and the heritage of Louis Vuitton, the seeds of which had been laid over 150 years ago by its founder, with the pressures to grow the business. How far could he push the Louis Vuitton machine without undermining those values?

[54] http://blogs.ft.com/material-world/2012/12/18/michael-burke-at-vuitton-old-hand-new-house-big-surprise/, accessed February 3, 2013.
[55] http://www.ft.com/intl/cms/s/0/699106c0-24eb-11e1-bfb3-00144feabdc0.html#axzz2JnN4m5oM, accessed February 3, 2013.

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Exhibit 1

WORLD LUXURY GOODS MARKET

Global Luxury Goods Market by Region and Estimated Growth Rates			
	Share of total market in 2011	Estimated Growth 2012 (Euro)	Estimated Growth 2012 (Constant K)
Americas	30%	13%	5%
Europe	37%	5%	3%
Japan	9%	8%	0%
Asia-Pacific	19%	18%	10%
Rest of the World	5%	8%	5%

Source: Claudia D'Arpizio, 2012 Luxury Goods Worldwide Market Study 11th Edition, Bain and Company, Milan, October 2012.

Exhibit 2

FINANCIALS FOR LVMH, PPR AND RICHEMONT

	LVMH		PPR		Richemont	
	2010	2011	2010	2012	2010	2011
Revenues	20,320	23,659	11,008	12,227	6,892	8,867
Gross Profit	13,136	15,567	5,369	6,224	4,394	5,651
Operating Profit	4,169	5,154	1,229	1,544	1,355	2,040
Net Profit	3,032	3,065	709	999	1,090	1,540
Shares Outstanding (mm)	478	492	126	126	566	560
Current Assets	11,199	13,267	6,940	5,277	7,024	8,595
Non Current Assets	25,965	33,802	17,754	17,508	2,659	3,158
Current Liabilities	7,060	9,594	6,495	5,472	2,213	2,722
Non Current Liabilities	11,900	13,963	6,549	6,133	488	413
Total Debt	5,266	7,266	5,219	4,678	222	88
Shareholder Equity	18,204	23,512	10,599	10,925	6,992	8,618

Source: LVMH Annual Reports. 2006 to 2011.

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Exhibit 3

LVMH REVENUE AND RECURRING OPERATING PROFIT BY BUSINESS GROUP

LVMH Revenue by Business Group			
	2009	**2010**	**2011**
Wines and Spirit	2,740	3,261	3,524
Fashion and Leather Goods	6,302	7,581	8,715
Perfumes and Cosmetics	2,741	3,076	3,195
Watches and Jewellery	764	985	1,949
Selective Retailing	4,533	5,378	6,436
Other activities/eliminations	-27	39	-27
	17,053	20,320	23,792

Profit from Recurring Operations by Business Group			
	2009	**2010**	**2011**
Wines and Spirit	760	930	1,101
Fashion and Leather Goods	1,986	2,555	3,075
Perfumes and Cosmetics	291	332	348
Watches and Jewellery	63	128	265
Selective Retailing	388	536	716
Other activities/eliminations	-136	-160	-242
	3,352	4,321	5,263

Source: LVMH Annual Reports. 2009 to 2011.

Exhibit 4

FASHION AND LEATHER GOODS REVENUE BY REGION

EUR Million	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**
Revenue	5222	5628	6010	6302	7581	8712
Asia	20%	23%	25%	28%	30%	32%
France	9%	9%	8%	8%	8%	8%
Europe	19%	20%	21%	21%	21%	20%
US	21%	20%	19%	18%	18%	18%
Japan	26%	22%	20%	18%	16%	14%
Rest of the World (ROW)	5%	6%	7%	7%	7%	8%

Source: LVMH Annual Reports. 2006 to 2011.

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Exhibit 5

LOUIS VUITTON COMPETITOR OVERVIEW

	Gucci		Botegga Veneta		Prada		Hermes		Chanel S.A.[1]		Coach		LV	
	2010	2011	2010	2011	2010	2011	2010	2011	2010	2011	2010	2011	2010	2011
Ownership status	Part of PPR PPR: Publicly Traded with 40% controlled by insiders		Part of PPR PPR: Publicly Traded with 40% controlled by insiders		Publicly Traded 80% controlled by insiders		Publicly traded. Hermes family controlled 50.2%		Privately Held		Publicily Traded		Part of LVMH LVMH: Publicily Traded with over 40% owned by Arnault Family	
Customer Segment Served	Aspirational Accessible		Absolute Aspirational		Aspirational Accessible		Absolute Aspirational		Absolute Aspirational		Accessible		Absolute Aspirational Accessible	
Distribution Channels	Direct owned stores Online		Direct Owned Stores Franchises Select Retail Stores Online		Direct Owned Stores Franchises (33 in 2010, 26 in 2011) Select Retail Stores Online		Direct Owned Stores (193 in 2010, 205 in 2011) Select Retailers (124 in 2010, 123 in 2011) Online		Direct Owned Stores Select Retailers		Direct Owned Stores Franchises Outlet Stores Select Retail Stores Licensing Online		Direct owned stores Online	
EUR Millions														
Revenues	2666	3148	511	683	2047	2556	2401	2841	NA	3000	3127	3581	7581	8712
Recurring Operating Income	757	946	130	205	418	629	668	885	NA	NA	981	1137	2555	3075
Stores	317	376	148	170	309	388	317	328	NA	NA			451	458
Prada revenues excludes royalties of 32m														
NA = Not Available														
Coach financials converted from US$ to euro at €1 = US$1.33														

Source: PPR, Prada, Hermes, Coach Annual Reports. 2010 to 2011.

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Exhibit 6

COMPETITOR SALES BY REGION – 2011

	Gucci		Botegga Veneta		Prada		Hermes		Coach	
	Revenue	**Growth**	**Revenue**	**Growth**	**Revenue**	**Growth**	**Revenue**	**Growth**	**Revenue**	**Growth**
Europe	881	13%	184	42%	986	17%	1055	17%	508	34%
Asia-Pacific (incl China)	1165	23%	239	46%	873	42%	808	17%		
China	708	29%	155	75%	525	40%	NA	NA		
Japan	378	4%	137	4%	257	16%	472	-1%	635	12%
Americas	567	19%	96	28%	393	20%	464	26%	2439	12%
ROW	157	NA	27	NA	15	29%	43	36%	NA	NA

Prada revenues excludes royalties of 32m

Coach financials converted from US$ to euro at 1 = US$1.33

NA = Not Available

Source: PPR, Prada, Hermes, Coach Annual Reports, 2011.