Case 3-4: LVMH: Managing the Multi-Brand Conglomerate

*The mission of the LVMH group is to represent the most refined qualities of Western "Art de Vivre" around the world. LVMH must continue to be synonymous with both elegance and creativity. Our products, and the cultural values they embody, blend tradition and innovation, and kindle dream and fantasy.**

On March 4, 2004, 54-year-old Bernard Arnault stood under his Picasso painting at the LVMH headquarters in Paris and pondered about the future of his fashion empire. He had just announced a 30% rise in net income for 2003; with improved profits in all sectors of the business except watches and jewelry. Margins for the flagship leather goods brand Louis Vuitton topped 45% due to increased publicity spending featuring the actress Jennifer Lopez in its latest global ad campaign.

As the chief shareholder in LVMH Moët Hennessy Louis Vuitton, plus ownership stakes in the high-profile labels of Christian Dior, Givenchy, Christian Lacroix, Kenzo, Céline, Emilio Pucci, Fendi, Loewe, Donna Karan, and a substantial investment in Marc Jacobs, Arnault held much of the future of world fashion in his hands. His properties also include Tag Heuer watches, Moët and Chandon champagne, and a chain of duty-free shops in many international airports. The fashion conglomerate's leadership in the luxury sector has been sustained by new product launches, store openings and an increased investment in communications. The group continued new launches and initiatives in 2004, including the new leather goods Damier Geant line, the Théda bags, an entire new jewelry line at Louis Vuitton, a new perfume for women at Dior, a new fragrance for men at Guerlain, an array of watch and jewelry creations, and the new Ellipse Cognac from Hennessy.

LVMH also continued to develop its worldwide distribution network. The Louis Vuitton brand, which celebrated its 150th anniversary, opened its largest store in the world in New York. Advancements in markets with significant potential for luxury products, such as Asia, also bolstered the group's performance. Future focus would likely be on new growth markets and regions such as China, a market with considerable potential for cognac, fashion and perfumes; Russia with its promise for Sephora, which had already shown promise in several Central and Eastern European countries; and India, where Louis Vuitton opened its first store in 2003.

However, the $12 billion fashion and liquor conglomerate controlled by Bernard Arnault was not without worries. Wall Street continued to question whether the company's multi-brand strategy could be sustained. Arnault had to consider the increasing importance of succession as he approached the legal retirement age and would soon need to plan for his successor who could replace him at the helm of his group.

Company Background

History

Established in 1987, LVMH was created by the fusion of two fashion houses: Louis Vuitton, a leather goods specialist founded in 1834, and Moët-Hennessy, a wine and spirits group created in 1971. The luxury group grew through key acquisitions and the development of new products. Under the leadership of Bernard Arnault, the 1990s saw a period of great expansion with the purchase of large stakes in the company's subsidiaries. In recent years, the luxury group had begun to shed-some of its portfolio, with the strategy of focusing on its *"star"* brands, defined by Arnault *as "timeless modern, fast-growing, and highly profitable"* brands (see Exhibit 1 for a list of the recent acquisitions and divestitures). Observers commented that;

> *"This collection of global brands was the stepping stone for realizing lucrative synergies in the fashion business, which would add to the bottom line."*

With over 56,000 employees and approximately €12 billion in revenue during the fiscal year 2003, the LVMH group operated in 5 primary sectors: wines and spirits, fashion and leather goods, perfumes and cosmetics,

---

The case was written by Ashok Som, Associate Professor, Management Department at ESSEC Business School, Paris. It is intended to be used as a basis for class discussion rather than to illustrate either effective or ineffective handling of a business situation. The author gratefully acknowledges Lilly Liu, Deepak Yachamaneni, ESSEC MBA Exchange students and Boris Gbahoue, ESSEC MBA student for their research help. The case was compiled from published sources and general experience.

* www.lvmh.com.

Exhibit 1 LVMH Conglomerate in a Glance

Wines & Spirits	Watches & Jewelry	Fashion & Leather	Selective Retailing	Perfumes & Cosmetics
Moët & Chandon*	TAG Heuer*	Louis Vuitton*	DFS*	Parfums Christian Dior*
Dom Pérignon		Loewe*	Miami Cruiseline Services*	Guerlain*
Veuve Clicquot*	Zenith*	Céline*	Sephora*	Parfums Givenchy*
Krug	Christian Dior Watches*	Berluti*	Le Bon Marché*	Kenzo Parfums*
Mercier	Fred*	Kenzo*	La Samaritaine*	Laflachère*
Ruinart	Chaumet*	Givenchy*		Bliss*
Château d'Yquem*	OMAS*	Christian Lacroix*		BeneFit Cosmetics*
Chandon Estates*		Marc Jacobs*		Fresh*
Hennessy*		Fendi*		Make Up For Ever*
Cloudy Bay		StefanoBi		Acqua di Parma*
Cape Mentelle		Emilio Pucci*		Perfumes Loewe*
Newton		Thomas Pink*		
MountAdam		Donna Karan*		

Acquisitions:

1987	Fashion house Céline
1988	Fashion house Givenchy
1991	Champagne brand Pommery
1993	Fashion house Kenzo
1994	Perfume company Kenzo, cosmetics company Guerlain
1995	Jeweler Fred
1996	Leather goods specialist Loewe
1997	DFS, the luxury goods distribution network
1998	Sephora, the fragrance and cosmetics retail chain
1999	Champagne producer Krug and the watch manufacturer TAG Heuer, a 34% minority stake in the Italian luxury goods maker, Gucci
2000	LVMH purchased the US start-up, Urban Decay, and Donna Karan apparel line
2001	La Samaritaine department store, Acqua di Parma perfumes, a stake in Fendi
2002	Millennium & Company, prestige wines and alcohol

New business creations:

1987	Christian Lacroix in 1987
2001	Newton and MountAdam vineyards
	Marketing De Beers diamond jewelry in a 50-50 joint venture

Divestitures:

2001	Sale of stake in Gucci to Pinault Printemps Redoute
2002	Pommery champagne brand, Hard Candy and Urban Decay
2003	Canard-Duchene to the Alain Thienot Group
	Final stake of 27.5% in Phillips, de Pury & Luxembourg, an auction house
	Minority stake in Michael Kors, including cosmetics and fragrance licenses
	Marc Jacobs and Kenneth Cole fragrance divisions
	Bliss spa line & Ebel watches

* Indicates company status.

watches and jewelry, and selective retailing. LVMH today controls more than 60 luxury brands across its product lines. The acquisition strategy at LVMH focused on brands that had strong brand power, resulting in the company reaching leadership positions in almost every segment it served. Each division functioned as a strategic business unit with its own general manager and a top management team. These divisions also managed overseas sales of their respective lines.

Wines & Spirits

Wines and spirits contributed 18% of sales and 36% of operating profit in 2003. LVMH, through Hennessy, holds 40% of the cognac market and between 20%–25% of the overall champagne market. In the premium champagne segment, LVMH has a dominant 50% share built around exclusive brands such as Moët Chandon and Veuve Clicquot. It also ventured outside the traditional wine belts in France and Italy to acquire high-end wine producers in California and Australia. Given the rising prominence of both California and Australia in the wine business, these moves allowed the company to market a truly global selection of wines and champagnes. However, considering the total liquor market, LVMH was not in the top 10 due to the absence of its drinks in the "Popular segment" like beers, whisky and vodka. However this is in line with LVMH's strategy to focus only on high margin activities. Analysts have suggested spinning off the wines and spirits businesses as a separate unit as they consider it to be non-core to LVMH's fashion image. For example, the sale of Pommery, a profitable champagne brand in 2001, was a strategic move by LVMH. The brand was bought for the vast lands it owned in the champagne region, as high quality land is limited in this region, LVMH wanted more land to produce more grapes for its Moët and Veuve brands of champagne. When Pommery was purchased, its land was also acquired but when it was sold, the land was retained and only the brand was sold.

Fashion & Leather Goods

The fashion and leather goods contributed 35% of sales and 60% of operating profit in 2003 and had an operating margin of 32%. Much of the sales of this division was concentrated in the Asia-Pacific region, particularly Japan, which accounts for 33% of sales, which in this segment are directly attributable to the Louis Vuitton brand. This label grew by leaps and bounds under the leadership of its legendary designer, Marc Jacobs. Demand for Louis Vuitton products often exceeded supply, requiring customers to go on a waiting list that often took several months to clear. The Louis Vuitton label, combined with the strength of the LVMH group, provided opportunities for expanding into new brands and products. Using this as a launching pad, the company engaged in significant brand expansion efforts to reach a wider audience. These efforts were well supported by fashion buyers.

The company leveraged synergies across its fashion brands. For example, its Kenzo production facility was transformed into a logistics platform for men's ready-to-wear products serving other brands such as Givenchy and Christian Lacroix. Given the historically lower profit margins in the ready-to-wear market, synergies resulting in cost savings boosted profitability. As Muriel Zingraff, Harrods' fashion and beauty director, observed,

> *"What I will say is that we may have more patience with smaller brands if they are owned by a parent company, such as LVMH or the Gucci Group."*

Perfumes & Cosmetics

The perfumes and cosmetics (P&C) unit contributed 18% of sales and 8% of operating profit in 2003. This division had an enviable collection of brands such as Christian Dior, Guerlain, Kenzo and Givenchy. The company recently acquired popular U.S. brands such as Bliss, Hard Candy, Urban Decay and Fresh geared toward a younger clientele. These acquisitions were an integral part of the drive to internationalize LVMH's perfumes and cosmetics offerings. Europe is the largest market for perfumes perhaps due to the heritage of the brands the company offered. The P&C division was able to leverage R&D synergies across brands, while its R&D expenditure remained in line with industry norms, LVMH was able to generate twice the average growth rate in the industry. It is believed that the R&D skills would help boost sales of the acquired companies. As part of a larger drive to consolidate margins in this division, the company integrated R&D, production, distribution, sourcing and other back-office operations across brands, moves that proved beneficial. For example, integrating the purchasing function across brands resulted in cost savings in raw materials of 20%. Analysts believed the division was well positioned to reap the spillover benefits arising from the co-branding strategy under which many of the brands were linked directly to ready-to-wear apparel brands, a unique avenue of differentiation at LVMH.

Watches & Jewelry

The latest portfolio addition at LVMH, watches and jewelry, contributed 4% of sales and –2% of operating profit in 2003. In the watches section, the company owned prestigious brands that included Tag Heuer, Ebel and Zenith. In jewelry, the company's brands included Fred Joallier and Chaumet. The purchase of the Zenith brand was crucial to LVMH's strategy to expand its watches operations. Most watches have an identical manufacturing process and brands reflect minor differences in quality. According to industry sources, there are only 3 manufacturers in the world from whom all the luxury watchmakers source their products. It is noteworthy that Zenith is the only manufacturer in the world of a certain component used in every watch. LVMH wanted a platform to sell more watches by utilizing its design experience and production know-how of Zenith. Watches could be one of the most lucrative segments at LVMH with margins as high as 80%.

Unlike its constellation of brands in other divisions, many think that the company does not have the same star power in watches and jewelry. Competitors such as Richemont, Hermès and Bulgari seem to have more recognizable brands and more upscale products in this category. However, tangible synergies appear to be a definite possibility because the division could centralize the manufacturing and utilize Tag Heuer's expertise in retail distribution across all brands. The jewelry business is also extremely competitive due to the presence of leading brands such as Cartier and Van Cleef & Arpels. Despite the Place Vendôme heritage of both Chaumet and Fred Joallier, neither of them is currently profitable.

Selective Retailing

Selective retailing contributed 25% of sales and 5% of operating profit in 2003. The vertical integration strategy of LVMH came to fruition when the selective retailing arm was established. The division manages LVMH investments in Sephora, DFS Galleria and Miami Cruiseline Services. While this division contributed 26% of company sales in 2002, it had not made a profit in the previous three years. DFS Galleria, with 150 duty-free and general merchandise stores, is the world's largest travel retailer. Acquired in 1996, the business was a victim of poor timing since the Asian financial crisis hit soon thereafter. LVMH since instituted several good management practices, including the execution of a strategy that would reduce DFS' reliance on Asian airports, selective closing of underperforming stores and the creation of DFS Galleria stores in large metropolitan areas. Despite these changes, Japanese travelers remained the company's most important and loyal customers and any economic development that hurt Japanese travel would invariably find its way to DFS' bottom line.

Miami Cruiseline Services (MCS) was acquired in January 2000. It offers retail services on cruise ships and accounts for 76% of the world's major cruise lines (over 100 ships) as its customers. Conceived as an extension of the DFS concept, Miami Cruiseline focused primarily (90%) on North American passengers, thus counterbalancing the over-reliance on Japanese tourists. It also managed duty-free operations at the Miami International Airport, the gateway to Latin America, opening possibilities of strengthening LVMH's brands in a region of the world where they have been underrepresented.

In addition to these distribution based assets, LVMH acquired La Samaritaine, the prestigious Paris department store. The company also entered the retailing end of the made-to-order tailoring business with the acquisition of Thomas Pink, the legendary Mayfair tailoring house that has a worldwide reputation for excellence in shirts. Thomas Pink has retail outlets in the United States as well. LVMH also took a minority stake in the 200-year-old U.K. fashion retailer, Asprey & Garrard that has global aspirations of its own.

Functioning of the Group

LVMH's five product groups are decentralised into production and distribution subsidiaries. Some of the major brands have their own national subsidiaries. Overlaying this, there is a regional structure, with corporate headquarters in Paris, New York, Tokyo, and Amsterdam. The wine and spirits operations of Moët Hennessy have its own headquarters, with main offices in France and regional headquarters in Singapore.

Depending on the geographic region, LVMH has different organizational setups. In France, the hub of LVMH has individual headquarters for every brand, with an LVMH headquarters handling some centralized activities. In contrast, in New York, the central LVMH office houses the LVMH and Givenchy brands, while Dior and Fendi have their own US offices. Tokyo centralizes the human resources function, and each brand operates independently on all aspects of business.

The Group's decentralised organizational structure helps the Company to foster efficiency productivity, and creativity. LVMH strives to create a highly motivating and dynamic atmosphere for its employees, emphasizing individual initiative and offers real responsibilities—often early on in one's career. LVMH gives each brand almost complete freedom to pursue its creative vision. However, it does realize synergies through almost 20% discount in advertising by negotiating in bulk for all its brands.

The challenge of this structure is that it requires highly entrepreneurial executive teams in each company within the Group. This entrepreneurial spirit requires a healthy dose of common sense from managers, as well as hard work, pragmatism, efficiency, and the ability to motivate people in the pursuit of ambitious goals.

Bernard Arnault: "The Pope of Fashion"

Dubbed "the Pope of Fashion," Bernard Arnault spent the past 15 years building LVMH from a small, clothing manufacturer to a conglomerate comprising approximately 50 of the world's most powerful brands. Trained as an engineer at the Ecole Polytechnique in France, Arnault joined his family's construction business where he worked for 13 years, before becoming president of the company in 1978. In 1984, he left his family business to reorganize a French state-owned holding company, Boussac, which owned Christian Dior. In the late 1980s, Bernard Arnault took control of LVMH. With growing success in his business, Bernard Arnault acquired Givenchy (1988) and Kenzo (1993). Today, through a complex web of partnerships, Bernard Arnault owns at least 33 percent of the company's stock.

Bernard Arnault is deeply involved in the creative process, far more than his peers. He believes that in the creative and highly seasonal fashion business, the ability to match effective CEOs with temperamental designers can make the difference between a star and a failure. He believes that *"to have the right DNA in a team is very rare. It's almost like a miracle."* Deemed the *"Billionaire Matchmaker,"* in the past 15 years he has formed close creative bonds with designer John Galliano, whose collections for Christian Dior have been hailed by fashion critics. His selection of Hedi Slimane did wonders for Dior Homme, and his pairing of Marc Jacobs with Louis Vuitton was a critical and financial success. His vision of the luxury and fashion industry as he states is:

> *"This link to creativity, it's not far from art, and I like it very much. You must like to be with designers and creators. You have to like an image. That's also a key to success. And at the same time, you must be able to organize a business worldwide."*

Industry Background

> *Luxury is not the opposite of poverty. It is the opposite of vulgarity*—Coco Chanel

> *We are in the business of selling dreams. The strength of a brand depends on how many dreams it inspires*—Chanel

The luxury products industry has been estimated to be worth $58 billion, excluding automobiles and travel. The breakdown by sector is shown in Exhibit 2.

Major players in the global luxury goods market include: LVMH Moët Hennessey Louis Vuitton, Richemont, Christian Dior, Gucci, Tiffany, Hermes, Swatch and Bulgari. Traditionally, the luxury sector has been highly fragmented, characterized by a large number of family-owned and medium-sized enterprises. In the past two decades, it has been increasingly dominated by multi-brand luxury conglomerates. Although smaller companies still thrive in this environment by serving niche markets, larger luxury goods companies have acquired or overtaken many of their smaller competitors (see Exhibit 3 for luxury market growth, by sector).

Survival of the Multi-Brand Strategy?

LVMH and France's biggest retail-to-luxury group Pinault-Printemps-Redoute (PPR), which controls Gucci, led the consolidation spree in the luxury industry in the late 1990s. More luxury conglomerates have emerged through acquisitions and many separate brands have united under a holding company structure intended to spread best practices and impose commercial and financial discipline. The goal is to allow firms to grow strongly without over-exploiting a particular brand and killing exclusivity.

However, Michael Zaoui, Morgan Stanley's head of mergers and acquisitions in Europe, doubts the viability of the multi-brand model, citing the slump in luxury M&A activity since 1999. *"It's a hotly debated issue . . . but is the multi-brand model holding up?"* asks Zaoui, whose investment bank has been involved in every Gucci acquisition since 1999 as well as the initial public offerings of Bulgari SpA and Burberry PLC.

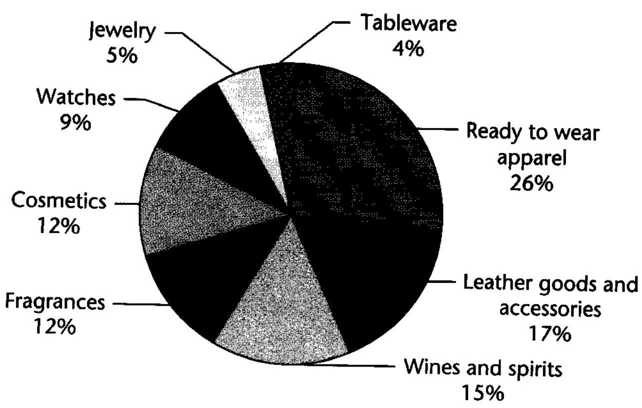

Exhibit 2 Breakdown of Luxury Goods Industry
Sources: Merrill Lynch Research.

Exhibit 3 Luxury Market Growth, by Sector

Sectors of the Luxury Products Industry	Annual sales growth, 1998–2002
Home fashions	>10%
Ready to wear	10
Accessories	10
Leather goods	<10
Watches and jewelry	8
Perfume and cosmetics	6
Crystal and silverware	5
Shoes	4

Source: Eurostat.

According to Zaoui, M&A in luxury goods slumped to $800 million in 2002 from $10 billion in 1999, and the rate of return on capital employed in the sector dropped to 20% in 2001 from 32% in 1997. As companies seek to stretch their brands to target new customers, some 1,400 new luxury goods stores have opened since 1999, the equivalent of strategic investments worth $4.5 billion. Large advertising budgets are required to attract people to the new stores. According to Zaoui, the 10 leading luxury companies spent $1.1 billion on advertising in 2001, which is equivalent to 8% of sales, compared with 6% of revenue in 1995. *"This expansion trend increases the inflexibility of the cost base . . . it can reduce margins if the growth's not there."*

"Luxury for the Masses"

There has been a systemic change in the luxury products market. In the past decade, Gucci sunglasses, Prada handbags and Louis Vuitton suitcases have become must-have items for many thousands of middle-class buyers. According to Boston Consulting Group's newly released book, *Trading Up: The Transforming Power of New Luxury*, the trend in the market is toward mass elitism. While traditional luxury brands such as Louis Vuitton, Rolls-Royce and Hermes remain items for the elite, luxury has been democratized for all. According to BCG, "new luxury" ranges from a Starbucks frappuccino to a Porsche and can be extended across categories like personal care, home wares and appliances, oral care, toys, restaurants and wines.

Consumers are in a "state of heightened emotionalism" and often address feelings of being overworked, isolated, lonely, worried and unhappy by shopping for premium-priced products. "New" luxury is the idea that middle-class consumers trade up to premium products because of emotional needs, to give them a sense of indulgence and personal fulfillment. They spend a disproportionate amount of their income on such goods and trade down in other categories perceived to be less important. For example, a consumer might visit a Dior boutique to spend several hundred dollars on a Gucci handbag, then go to Wal-Mart or Carrefour to buy cotton socks.

This new middle class market for luxury products creates a wide range of challenges for luxury conglomerates like Gucci and Louis Vuitton, as they have to understand and cater to a different target consumer.

Market Trends

In 2003, the luxury retail market segment was adversely affected by SARS (Severe Acute Respiratory Syndrome) in Asia, the United States led a war against Iraq, the Euro was strengthening and a weak "feel good factor" was spreading worldwide. SARS in Asia—which represents 30% of sales in the luxury retail market segment—led to a general decline in travel and spending. Consumers in the United States spent less in 2003 due to the war in Iraq and a weak economy. According to a study by Cotton Inc., published by Women's Wear Daily, consumers put 39% of their disposable income into savings and 14% to pay down debt in 2003. The strengthening of the Euro led to a drop in tourism, which translated into lower sales in the luxury retail segment since a significant portion of luxury retail sales is generated by Japanese tourists. A strong Euro also means equal sales in foreign currencies appear as less Euro revenues. All of these events contributed to the weak "feel good factor" in 2003.

The luxury sector is cyclical and partially correlates to economic conditions. The luxury retail market segment appeared to be rebounding in 2004 after two years of lackluster performance. Mr. Arnault predicted that the coming years would be *"very good for luxury because the world economy is doing well. The U.S. is booming, interest rates are very low and there is a lot of optimism, Japan recovering, and China and the Far East are growing fast."* Consumers dug into their pockets during the 2003/2004 holiday season to purchase more of the finer things in life. This turnaround in the luxury retail market segment ended the slump that plagued the market since the September 11, 2001, terrorist attacks.

However, signs of a turnaround in the luxury retail market were surfacing as consumer confidence improved and spending increased. In addition, performance in the luxury retail market segment was expected to improve throughout 2004. According to Mike Niemira, chief economist for the New York-based International Council of Shopping Centers, *"2004 will be a year of transition. Luxury items are strong and I think they are going to continue to be strong."* Consumer spending in the United States was propelled by the rebounding stock markets, President Bush's $350 billion tax cut plan and improving employment rates. Consumer spending in Asia also recovered after the SARS epidemic.

In the long term, growth opportunities for the luxury retail market remained positive. The luxury retail market was driven by Japan, Europe and the United States; however, the market would go on to include other parts of Asia such as China and Eastern Europe as the regions became richer.

Competition

Traditionally, the luxury goods sector has been very fragmented and dominated by small and medium size companies, which have over the years developed an expertise in a particular product. But since the late 1990s, the boom years, the sector was governed by multi-product and multi-brand conglomerates. Growth by acquisitions was an important strategy for all major players in the industry. Conglomerates tried to preempt each other in acquiring brands that had managed to survive successfully. The race changed the dynamics of the industry from "creativity focused" to more "financially focused." The years since 2000 seriously dampened spirits as sales stagnated and the conglomerates paid a heavy price for their acquisition spree.

As the luxury goods industry looked to move beyond the three turbulent years, the independent and family-controlled companies that yielded the spotlight to sprawling conglomerates during the boom years were claiming a measure of vindication. Leaders of several of the world's leading fashion houses said their strategy of resisting corporate advances had worked. It gave them better control over product direction at a time when consumers were showing signs of weariness with the glitz and type of some of fashion's biggest names. *"Never be exploited; don't give up control of design,"* says Giorgio Armani, head of the company he owns.

While keeping it in the family made sense from a brand-development standpoint, it had limitations. During the past three years, a weak global economy tested the financial resources of a number of family-owned luxury goods houses. There was also the question of what would happen to companies that became associated with the name, charisma and creativity of a larger-than-life founder. While Armani himself steadfastly resisted the idea of offering shares to the public, he refused to rule out the option of bringing in a big strategic investor, expressing willingness to partner with LVMH or PPR.

Selling to a bigger holding company does not always mean that a formerly privately controlled designer had to compromise on identity. When Phillips-Van Heusen bought Calvin Klein to help the biggest U.S. shirt maker compete against department stores, industry insiders were skeptical that Klein would be able to retain complete design control over his empire. Finances at one of the world's most recognizable brands were dismal. The designer had reportedly been losing up to $25 million a year on its couture collection and millions more on retail operations. Rather than clamping down on Klein's creativity, Phillips spun the label into two new midrange sportswear lines and pledged to cut costs while keeping Klein's 100 designers. Klein continues to play an important role in the image-making of the company. This is an example that shows how designers can funnel their creative energies and coexist with large conglomerates that offer substantial financial support—as both parties have adopted a middle path in the quest for control.

GUCCI-PPR: What after Tom Ford?

Originally a reseller of luggage imported from Germany, Gucci took advantage of the economic expansion following World War I. Since then, the company displayed an innovative streak, improvising leather alternatives. After World War II, Gucci began its global expansion strategy with a store in New York in 1953. The company suffered setbacks in the 1970s and 1980s after scandals and murder plots. There was intense fighting within the Gucci family that resulted in poor strategy and dilution of valuable brand equity. In the late 1980s, Investcorp bought 50% of the company. The revival of Gucci commenced with the appointment of Domenico De Sole as the CEO, who hired Tom Ford, a highly acclaimed designer who revamped Gucci's product designs. The company took firmer control of the brand, its products and the distribution. Investcorp sold its holdings through an IPO in 1996, making a five-fold return on its original investment. This was followed by a bitter battle for control of Gucci by LVMH and PPR. Finally, after poison pill measures taken by Gucci management failed to deter LVMH, PPR raised its offer and took control of the group. The move was welcomed by Domenico De Sole and Tom Ford, who preferred PPR to LVMH for fear of losing their "creative license" if LVMH took over Gucci.

Gucci started a multi-brand model later than LVMH. It acquired Yves Saint Laurent's fragrance and ready-to-wear apparel lines and added the renowned shoemaker, Sergio Rossi, to its umbrella of brands. The multi-brand strategy was expected to deliver important synergies. Unfortunately, the benefits were never realized and all YSL pulled down the group's earnings year after year. In the meantime Gucci continued its aggressive ascent choreographed by De Sole and Ford. The brand is strong in North America today and its strategy of portraying Gucci as a youthful and sensuous brand has appealed immensely to Americans.

After the PPR group acquired a majority control of Gucci, it started infringing on the independence enjoyed by the creative duo of De Sole and Ford. It is ironic that the very same group that was supposedly chosen to protect the creative freedom was curtailing it. Tensions with the chairman of PPR group, Pinault, led to both De Sole and Ford refusing to renew their contracts after 2004.

According to analysts, *"The decade old revival of Gucci from almost a dead brand to one of the most promising ones today made Mr. Tom Ford a bigger name than Gucci and PPR would have immense trouble replacing him."* Adding to PPR's woes, in September 2003 a US court started investigations against Pinault for fraud in an unrelated acquisition in the 1990s. These drawbacks indeed have put a question mark on whether Gucci and PPR can continue their growth in future after Ford exits.

A nagging concern for the PPR group is whether Ford is going to be hired by rival LVMH group. Bernard Arnault was openly critical of Pinault and De Sole but refrained from saying anything against Ford, since the Gucci episode in 2000. He was quoted as crediting Ford as *"one of the best designers of his time."* This could reflect Arnault's intention to hire Ford after his exit from Gucci, which would significantly affect the dynamics at LVMH. Sources familiar with the situation feel that Ford is more likely to join a smaller company or launch his own label than join LVMH. The reason for his quitting is the constraint over his freedom, and given the temperament of Mr. Arnault, Ford might not want an association with LVMH.

This has created a buzz in the industry as to where Ford is headed and also whom PPR would recruit to replace him. It seems particularly interesting as the new job profile for the position of Head of Gucci is a person out of the luxury industry. It remains to be seen if this proves a good option to recruit a person from outside the luxury industry for the top position and how a key figure in this industry can make, break or manage a conglomerate.

Managing a Multi-Brand Conglomerate

Creativity and innovation are synonymous with success in the fashion business. As two analysts recently observed, *"Luxury brands must foster an appreciation and tolerance for creativity that is unconstrained by commercial or production constraints."* In almost all its acquisitions, LVMH maintained the creative talent as an independent pool without attempting to generate synergies across product lines or brands. Lately though, the sourcing has slowly been centralized to gain synergies and cost savings with centralized purchasing mechanism.

Bernard Arnault believes that, *"If you think and act like a typical manager around creative people—with rules, policies, data on customer preferences, and so forth—you will quickly kill their talent."* The company has been decentralized by design and has a very small cadre of managers.

However, industry insiders cite that all is not well with a financial man like Bernard Arnault at the helm. His management style is described as providing "constrained freedom." For example, a manager for Céline could recruit a person himself, independent of the central LVMH human resources department, but he must send a copy of the CV of the person he hired so the head office is aware of the new development. Though his managers are given autonomy, they know they are being watched and who has the final word in case of any conflict.

Another concern is the ruthless pursuit toward the bottom line. LVMH believes in running businesses profitably. Managers are supported as long as they make money over the stipulated minimum. *"You have the freedom as long as you exceed your targets. Once you do not . . . there is no freedom anymore."* The emphasis is on profit and if any division or company did not deliver, it would promptly be sold off. This approach contrasts with the traditional and creative view of Haute Couture, which though loses money on different sets of collections, waits for the market to accept its designs over a period of time.

Managing "Star Brands"

The core pillar of LVMH's current business strategy is "star brands," coupled with innovation and quality. More specifically, Bernard Arnault describes the group's stellar financial performance in 2003 *as "a consequence of the priority placed on internal growth and profitability, the development of brands around the dual goals of innovation and quality, and the conquest of new markets"* (see Exhibit 4 for key financials). According to Bernard Arnault, a star brand is:

> *"timeless modern, fast-growing, and highly profitable. . . . There are fewer than 10 star brands in the luxury world, because it is very hard to balance all four characteristics at once—after all, fast growth is often at odds with high profitability—but that is what makes them stars. If you have star brand, then basically you can be sure you have mastered a paradox."*

According to him, star brands are born only when a company manages to make products that *"speak to the ages"*

Exhibit 4 Consolidated Group Performance (in € millions)

	2002	2001	2000	1999	1998	5 Yr. Growth
Total Current Assets	7 168	8 260	8 280	6 887	5 414	32,40%
Total Current Liabilities	6 890	8 017	9 829	8 615	6 328	8,88%
Total Assets	20 658	22 540	21 124	19 671	16 008	29,05%
Total Liabilities	12 864	15 122	14 947	13 194	9 408	36,73%
Total Common Equity	6 022	5 618	4 696	5 400	5 736	4,99%
Income Statement	**2002**	**2001**	**2000**	**1999**	**1998**	**5 Yr. Growth**
Sales	12 693	12 229	11 581	8 547	6 936	83,00%
Cost of Goods Sold	3 806	3 466	3 821	2 698	2 197	73,25%
Net Income	556	10	705	636	429	29,65%

Source: Thomson Analytics Financial Database.

but the feel is intensely modern. Such products are designed to sell fast, raking in profits for the fashion empire. This is a paradox and he confides that *"mastering the paradox of star brands is very difficult and rare."*

Bernard Arnault has never specified what those 10 "star brands" were, but using his criteria, the following luxury labels could be considered star brands: Christian Dior, Louis Vuitton, Hermes, Cartier, Giorgio Armani, Gucci, Chanel and Prada (see Exhibit 5). Of these, LVMH controls just two—Dior and Vuitton, of which he says:

> *"If you take Vuitton, which has existed for more than 150 years, I think, today, it is also modern. Dior has been there for 50 years, but also I think it is the most hip fashion brand today."*

Innovation. Bernard Arnault believes that innovation *"is the ultimate driver, of growth and profitability. Our whole business is based on giving our artists and designers complete freedom to invent without limits."* He has acknowledged past mistakes, including the rapid expansion of the Sephora

Exhibit 5 Representative Primary Competitors, by Business Unit

Product Sector	LVMH Businesses	Primary Competitors
Fashion and Leather Goods	Louis Vuitton, Loewe, Céline, Berluti, Kenzo, Christian Lacroix, Givenchy, Marc Jacobs, Fendi, StefanoBi, Emilio Pucci, Thomas Pink, Donna Karan	Prada, Versace, Armani, Saint-Laurent, Chanel, Ralph Lauren, MaxMara, Burberry, Ferragamo, Hugo Boss, Gucci, Hermès, Bulgari, Lancel, etc.
Jewelry and Watches	TAG Heuer, Zenith, Dior Watches, FRED, Chaumet, OMAS*	Oméga, Breitling, Vendôme-Cartier, Cartier, Van Cleef & Arpels, Rolex, Baume et Mercier
Perfume and Cosmetics	Parfums Christian Dior, Guerlain, Parfums Givenchy, Kenzo Parfums, Laflachère, BeneFit Cosmetics, Fresh, Make Up For Ever, Acqua di Parma, Perfumes Loewe*	Many brands, including Lancôme, Lanvin et Armani, all brands under L'Oréal, Chanel, Yves Saint-Laurent, Gautier, Calvin Klein, Ralph Lauren, Estée Lauder, Shiseido, Hard Candy*, Bliss*, specialty perfumeries, etc.
Wines and Spirits	Moët & Chandon, Dom Pérignon, Veuve Clicquot, Krug, Mercier, Ruinart, Château d'Yquem, Chandon Estates, Hennessy, Cloudy Bay, Cape Mentelle, Newton, MountAdam	Pommery*, Marne et Champagne, Laurent Perrier, Seagram, Johnny Walker, Smirnoff, Rémy Cointreau, Remy Martin, Courvoisier, etc.
Distribution	DFS, Le Bon Marché, La Samaritaine, Sephora, sephora.com, Miami Cruiseline Services	Many stores and retailing franchises

*Indicates former LVMH businesses.

Exhibit 6a Net Sales by Business Group

(EUR million)	2001	(1)	2002	(1)	2003	(1)
Wines & Spirits	2 232	18%	2 266	18%	2 116	18%
Fashion & Leather Goods	3 612	30%	4 207	33%	4 149	35%
Perfumes & Cosmetics	2 231	18%	2 336	18%	2 181	18%
Watches & Jewelry	548	4%	552	4%	503	4%
Selective Retailing	3 493	29%	3 337	26%	3 039	25%
Other businesses and eliminations	113	1%	−5	0%	−25	0%
Total	**12 229**		**12 693**		**11 963**	

(1) As a % of total sales.

Source: LVMH 2003 Annual Report.

Exhibit 6b Income from Operations by Business Group

(EUR million)	2001			2002			2003		
		(1)	(2)		(1)	(2)		(1)	(2)
Wines & Spirits	676	43%	30%	750	37%	33%	796	36%	38%
Fashion & Leather Goods	1 274	82%	35%	1 280	64%	30%	1 311	60%	32%
Perfumes & Cosmetics	149	10%	7%	161	8%	7%	178	8%	8%
Watches & Jewelry	27	2%	5%	−13	−1%	N/S	−48	−2%	N/S
Selective Retailing	−213	−14%	N/S	20	1%	1%	106	5%	3%
Other businesses and eliminations	−353	−23%	N/S	−190	−9%	N/S	−161	−7%	N/S
Total	**1 560**			**2 008**			**2 182**		

(1) As a % of total sales.
(2) Operating Margin.
Source: LVMH 2003 Annual Report.

beauty and fragrance supermarkets, for which he said LVMH paid too much. After expanding too quickly in the United States, the company had to close stores and reposition the unit. In a business based on giving artists and designers the freedom to create without limits, LVHM allows each brand to run itself, headed by a creative director. Only 250 out of the 56,000 employees are based in the Paris headquarters; the essence of the business is to identify the right creative people to stimulate new and cutting edge ideas and trusting their instincts.

Quality. In the luxury products business, quality is essential in production as well as in product development. This is also an essential element in LVMH's success strategy. For example, to exercise the utmost control over the quality of its Louis Vuitton "star brand," the company owns manufacturing facilities employing more than 4,000 in France, Spain and in the United States, among other countries. While LVMH produces its Louis Vuitton brand in-house, the firm outsources part of the production of its other fashion labels, such as Céline and Fendi. *"For all of our brands, we manufacture part of the overall production within our facilities to be sure that there is a consistency between what is done by external sub-contractors and what we do,"* explained Jean-Paul Vivier, executive vice president of the LVMH Fashion Group.

Managing People

Human resources and management of talent are critical for the luxury conglomerate. When Arnault first began his consolidation, the group was full of problems and only a few of the companies were profitable. HR Director Concetta Lanciaux confided that his primary concern

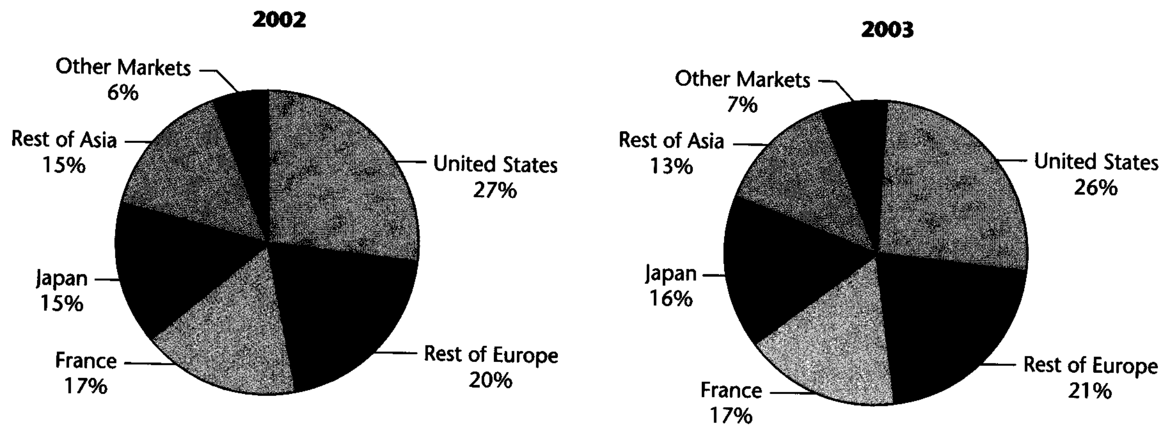

Exhibit 7 Net Sales by Geographic Region

Source: LVMH 2003 Annual Report.

was to *"have the best managers."* Lanciaux's challenge was particularly difficult because there was a scarcity of executives in luxury goods at the time. Most firms were small, family-owned companies, without graduates or succession planning LVMH had to recruit and develop talent from different fields. Regarding the mobilization of LVMH's resources Bernard Arnault said:

> *"In a global context, progress of LVMH in 2003 will be based above all on the excellence of the fundamentals and its capacity to mobilize its internal resources. We can rely on our traditional strengths, namely the talent of our managers and employees and their determination to make the difference, the appeal of our major brands, the certain values—more than ever in a difficult period, the creativity and excellence of our products and the power of our distribution networks.*
>
> *We are continuing to deploy the organic growth strategy[. . .] while still carrying out the sale of non-strategic assets, we will maintain strict management focus, enabling us to reinvest the cost savings achieved in the driving forces of our growth."*

LVMH encouraged and passed on the know-how, skills, the spirit of excellence and the ethic that conveys, through its creations and products, an exceptional art of living, which is appreciated worldwide. The awakening and education of young people to these values has always constituted an essential part of the Group's goal. LVMH carried out various original initiatives for young people in France and abroad. It is through these initiatives that primary school children, high school students, art students, young artists and designers, as well as those closer to the Group's new work opportunities such as college and higher education students, can benefit. In 1991, for example, LVMH partnered with Paris-based business school ESSEC to launch the luxury brand marketing LVMH ESSEC chair, funded with FF10 million. Further partnerships have since been launched in Asia as well.

The company had to hire people with experience in other industries, such as consumer goods, and select people with "good taste." Lanciaux cited engineering and business schools as specific sources of talent. LVMH also instituted strong company-wide induction and training program as well as on-the-job training to introduce the world of luxury to its capable, bright novices to the industry. Lanciaux explained:

> *"With some 40 brands potentially competing against each other in the group, recruitment and everyday business becomes complex. In the case of our group, what builds value and profits is the ability to act in*

Exhibit 8 LVMH Global Reach (Number of Stores in 2003)

North America	344
Latin America	16
France	277
Europe	401
Africa & Middle East	6
Asia	287
Japan	232
Pacific Region	29

Source: LVMH 2003 Annual Report.

Exhibit 9 Benchmarking Louis Vuitton vs. Other Luxury Brands

Brand	2003 Sales (Billions)	Percent Change*	Operating Margin
Louis Vuitton	$3.80b	16%	45.0%
Prada	$1.95b	0.0%	13.0%
Gucci**	$1.85b	−1.0%	27.0%
Hermes	$1.57b	+7.7%	25.4%
Coach	$1.20b	+34.0%	29.9%

*At constant rate of exchange.
**Gucci division of Gucci Group.
Source: Company reports, BusinessWeek.

an autonomous way and create new products. The business is built on the number of innovative products that come out every year—20% to 30% of the turnover is based on new products. Therefore our companies' senior executives have to have a large dose of autonomy and creative capacity. People use these as aspirational products, so we need people who manage and dream—and make others dream."

Despite the group's aggressive growth through acquisition, LVMH tried to treat such moves sensitively, with a vision of integration. Lanciaux commented:

"First of all, it was about respecting, identifying and then preserving all of the assets of the Company—not changing everything at once. One of the mistakes that companies in this situation make is that they want to change everything and bring in their own culture. When we buy these brands, we buy them to develop them. To develop the brand, the first thing you need to know is what makes that brand. Very often it's a number of people who are behind it, often invisible. . . . You have to find them, make them visible. This means that we have been able to preserve the integrity of these brands. Our style is not to go in there and replace everybody—never."

Jean-Paul Vivier, executive vice president of the LVMH, agrees that the group seeks to foster creativity not just among its design teams but also with professionals throughout the business. He compares the process to mixing the perfect cocktail—LVMH tries to build a work environment that promotes creativity and at the same time adheres to strict business disciplines.

Integration, training and top management seminars designed to support business strategies played an essential role in the professional development of the LVMH Group. Since 2001, it steadily increased the number of training days for all personnel categories within the Group and in centers located in Paris, New York, Hong Kong and Tokyo. The total number of training days in 2001 was 103,585 worldwide. Each of the companies developed a specific training program that reflects its own vision of excellence and strategic objectives. At Louis Vuitton, which operates in 44 countries, vendors from all over the world participate in "brand immersion" seminars organized in Asnières, the company's birthplace and communications center. They tour the workshops built in 1859 and the Louis Vuitton travel museum. These sites are filled with the spirit of the company, which has remained constant even as it adapts to changing fashions and trends—a spirit embodied in the skills of the craftsmen, the details, and a unique talent for anticipating, analyzing and meeting the requirements of the contemporary world. In 1999, Hennesy developed a teaching game called "Strateco" that takes place over two days. It is designed to make all non-managerial employees more aware of economic influences affecting the companies and their operating realities. Another program, *"Decompartimentalizing people and their jobs,"* presents the mission, organization and business of each department to the company's managers and brings together participants from the various departments. Finally, the inter-company seminars offered to all of the Group's manager's focus on topics of mutual interest and are primarily designed to develop or perfect management, communication and leadership skills.

American designer Michael Kors joined LVMH and successfully revived Céline, a dusty brand. However, it didn't seem that anyone at LVMH noticed. During Kors' six and a half year tenure at Céline, the position of chief executive officer turned five times, from Nan Legeai, to Bernard Divisia, Yves Carcelle, Thierry Andretta and, finally, to Jean-Marc Loubier. At the same time, Bernard

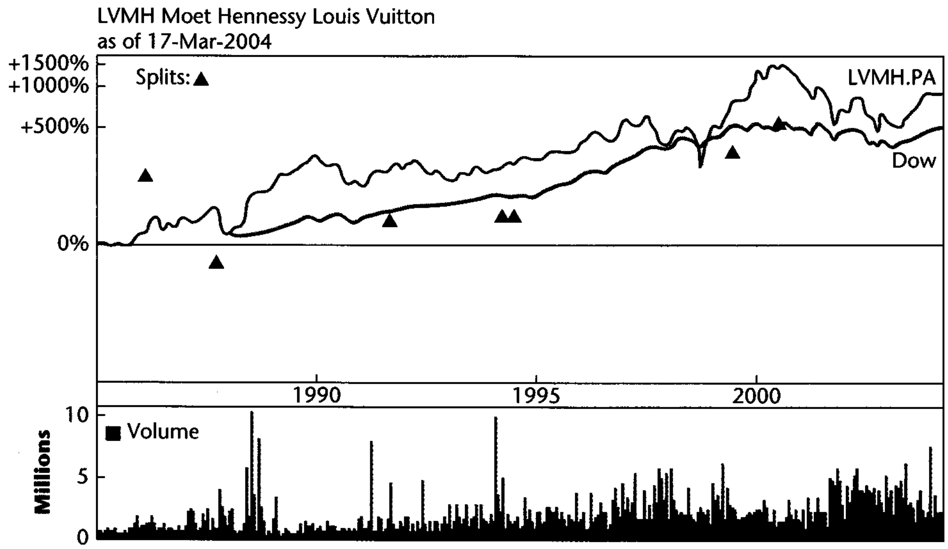

Exhibit 10 LVMH Stock Performance, 1985 to March 2004

© 2003 Yahoo! Inc. http://uk.finance.yahoo.com

Arnault attended only two of Kors' fashion shows for Céline. In total, Kors estimated that he spent a total of three hours in Bernard Arnault's company, including the two shows and two "hellos" when he ran into Arnault at the Dior store in Paris. Kors said:

> *"Was I mistreated? No. Was I neglected? Yes. I never felt as though there was a strategy at LVMH as far as pitting the designers against each other or the brands against each other. It's just that I never felt anyone was watching the smaller companies at all, but everybody was spending their time on the two first-born children—Louis Vuitton and Christian Dior. In a way, if you're a nice kid, no one pays attention to you. If you are a bad kid, you get spoiled."*

Interesting is the case of Marc Jacobs. In 1997, Marc Jacobs was struggling to keep his namesake brand afloat.

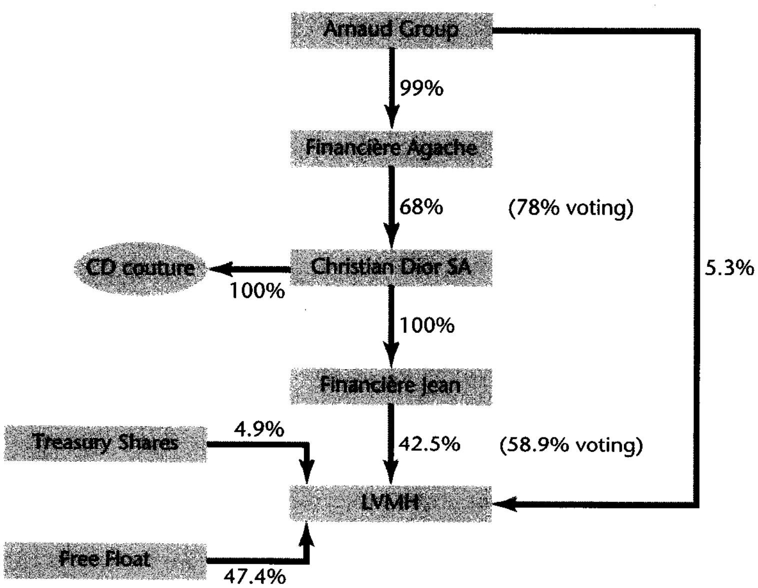

Exhibit 11 LVMH Group Shareholder Structure

Source: Company data, UBS Warbung.

Exhibit 12 The 15 Leadership Factors

Identified by 450 LVMH Group senior executives during LVMH House sessions (October 2001)

Creativity
Comes up with a lot of new and unique ideas; easily makes connections among previously unrelated notions; tends to be seen as original and value-added in brainstorming sessions.

Strategic Agility
Sees ahead clearly; can anticipate future consequences and trends accurately; has broad knowledge and perspective; is future oriented; can articulately paint credible pictures and visions of possibilities and likelihood; can create competitive and breakthrough strategies and plans.

Innovation Management
Is good at bringing the creative ideas of others to market; has good judgment about the creative process of others; can facilitate effective brainstorming; can project how potential ideas may play out in the market place.

Managing Vision & Purpose
Communicates a compelling and inspired vision or sense of core purpose; talks beyond today; talks about possibilities; is optimistic; creates mileposts and symbols to rally support behind the vision; makes the vision sharable by everyone; can inspire and motivate entire units or organizations.

Customer Focus
Is dedicated to meeting the expectations and requirements of internal and external customers; gets first-hand customer information and uses it for improvements in products and services; acts with customers in mind; establishes and maintains effective relationships with customers and gains their trust and respect.

Priority Setting
Spends his/her time and the time of others on what's important; quickly zeros in on the critical few and puts the trivial many aside; can quickly sense what will help or hinder accomplishing a goal; eliminates roadblocks; creates focus.

Building Effective Teams
Blends people into teams when needed; creates strong morale and spirit in his/her team; shares wins and successes; fosters open dialogue; lets people finish and be responsible for their work; defines success in terms of the whole team; creates a feeling of belonging in the team.

Action Oriented
Enjoys working hard; is action oriented and full of energy for the things he/she sees as challenging; not fearful of acting with a minimum of planning; seizes more opportunities than others.

Drive for Results
Can be counted on to exceed goals successfully; is constantly and consistently one of the top performers; very bottom-line oriented; steadfastly pushes self and others for results.

Hiring and Staffing
Has a nose for talent; hires the best people available from inside or outside; is not afraid of selecting strong people; assembles talented staffs.

Motivating Others
Creates a climate in which people want to do their best; can motivate many kinds of direct reports and team or project members; can assess each person's hot button and use it to get the best out of him/her; pushes tasks and decisions down; empowers others; invites input from each person and shares ownership and visibility; makes each individual feel his/her work is important; is someone people like working for and with.

Business Acumen
Knows how businesses work; knowledgeable in current and possible future policies, practices, trends, and information affecting his/her business and organization; knows the competition; is aware of how strategies and tactics work in the market place.

Integrity and Trust
Is widely trusted; is seen as a direct, truthful individual; can present the unvarnished truth in an appropriate and helpful manner; keeps confidences; admits mistakes; doesn't misrepresent him/herself for personal gain.

Learning on the Fly
Learns quickly when facing new problems; a relentless and versatile learner; open to change; analyzes both successes and failures for clues to improvement; experiments and will try anything to find solutions; enjoys the challenge of unfamiliar tasks; quickly grasps the essence and the underlying structure of anything.

Delegation
Clearly and comfortably delegates both routine and important tasks and decisions; broadly shares both responsibility and accountability; tends to trust people to perform; lets direct reports finish their own work.

Bernard Arnault approached him with an irresistible offer to lend his creative flair to the venerable but stodgy Louis Vuitton label in return for LVMH underwriting his beleaguered design firm.

Jacobs' designs helped boost sales and buzz around the $3.8 billion Louis Vuitton brand, which accounts for 60% of LVMH's operating profit. His multicolored Murakami handbag alone drove more than $300 million in sales. The 41-year-old designer also developed his own Marc Jacobs label, which soared to about $75 million in sales in 2003, helped by a $50 million investment from LVMH.

However, tensions arose between the designer and the company. Jacobs believes his ambitions to develop his own brand were hindered by LVMH. He complained that the French conglomerate hadn't invested enough in the Marc Jacobs business and locked him out of critical decisions about the operations at his own line. For example, in May 2003, LVMH, while closing its U.S. fragrance division, sold the Marc Jacobs perfume too to Coty Inc. without informing or consulting the designer. None of the proceeds went to Jacobs, instead went directly to LVMH.

Due to its heavy dependence on creative and modern designs, the departure of key creative personnel would be devastating to Vuitton. There was speculation that Jacobs might leave unless LVMH gave more backing to his clothing line. As seen in the example of Tom Ford and Domenico De Sole's departures from luxury rival Gucci, losing its young star designer could spell trouble for the Louis Vuitton brand.

In May, 2004 a spokesman in Paris confirmed that Moët Hennessy Louis Vuitton SA had resolved a year-long dispute with New York designer Marc Jacobs, the artistic director of Loius Vuitton, and his business partner Robert Duffy, president of Marc Jacobs, by signing them to 10-year employment contracts and committing to invest in the partners' Marc Jacobs International fashion house. Under the new agreement Marc Jacobs and Robert Duffy received salary raises—and for the first time—stock options. According to Robert Duffy,

> *"Now Marc and I can achieve our dream of turning Marc Jacobs into a global powerhouse."*

The Future

While the Louis Vuitton brand remains enormously profitable, none of the other labels have rivaled its level of commercial success. With its current dependence on star designers such as John Galliano and Marc Jacobs, the group's success is highly correlated to the whim of the creative. Given the current internal politics and recent departure of Michael Kors, will consumers remain loyal to the brand or the designer? The bigger question is, can LVMH oversee so many luxury brands, make them all profitable and maintain the highest standards of creativity? How will this "loose" conglomerate that Bernard Arnault created in the last decade be integrated and managed effectively?