

Coach Inc. in 2012: Its Strategy in the “Accessible” Luxury Goods Market

CASE 7

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Coach Inc.'s strategy that created the “accessible” luxury market in ladies handbags made it among the best-known luxury brands in North America and Asia and had allowed its sales to grow at an annual rate of 20 percent between 2000 and 2011, reaching \$4.2 billion. During that period, the company's net income increased from \$16.7 million to \$880 million. In 2012, Coach Inc. designed and marketed women's and men's bags, leather accessories, leather apparel items, business cases, footwear, jewelry, travel bags, watches, and fragrances. All of the company's leather products were manufactured by third-party suppliers in Asia, while Coach-branded footwear, eyewear, watches, and fragrances were made available through licensing agreements.

Coach's strategy, which focused on matching key luxury rivals in quality and styling while beating them on price by 50 percent or more, yielded a competitive advantage in attracting not only middle-income consumers desiring a taste of luxury, but also affluent and wealthy consumers with the means to spend considerably more on a handbag. Another distinctive element of the company's strategy was its multichannel distribution model, which included indirect wholesale sales to third-party retailers but focused primarily on direct-to-consumer sales. In 2012, Coach operated 345 full-price retail stores and 143 factory outlets in North America, 169 stores in Japan, and 66 stores in China, along with Internet and catalog sales. The direct-to-consumer segment accounted for 87 percent of the company's 2011 net sales. Coach's indirect wholesaler segment had 2011 net sales of \$540 million, with the U.S. wholesale segment serving about 970 department store locations and the Coach International group supplying 211 department store locations in 20 countries.

The company's two primary strategic priorities in 2012 were to increase global distribution and improve

same-store sales productivity. The company's strategy focused on five key initiatives:

- Build market share in North America by opening approximately 15 new full-price retail stores and 25 factory outlets.
- Build market share in Japan through the addition of 15 new locations.
- Raise brand awareness and build share in under-penetrated markets, including Europe and South America and, most notably Asia, with 30 new locations planned in the region.
- Increase sales of products targeted toward men. Specifically, new store openings in North America and Japan would focus on men's products, while the new shops in China would offer dual-gender product lines.
- Raise brand awareness and build market share through coach.com, global e-commerce sites, and social networking initiatives.

While the company's performance was commendable and its strategy seemed to have merit, the company's profit margins were still below the levels achieved prior to the onset of a slowing economy in 2007. In addition, its share price had experienced a sharp decline during the first six months of 2012. Going into fiscal 2013, it was undecided if the company's recent growth could be sustained and its competitive advantage would hold in the face of new accessible luxury lines launched by such aggressive and successful luxury brands as Michael Kors, Salvatore Ferragamo, Prada Giorgio Armani, Dolce & Gabbana, and Versace.

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COMPANY HISTORY

Coach was founded in 1941 when Miles Cahn, a New York City leather artisan, began producing ladies handbags. The handbags crafted by Cahn and his family in their SoHo loft were simple in style and extremely resilient to wear and tear. Coach's classic styling and sturdy construction proved popular with discriminating consumers, and the company's initial line of 12 unlined leather bags soon developed a loyal following. Over the next 40 years, Coach was able to grow at a steady rate by setting prices about 50 percent lower than those of more luxurious brands, adding new models, and establishing accounts with retailers such as Bloomingdale's and Saks Fifth Avenue. The Cahn family also opened company-owned stores that sold Coach handbags and leather accessories. After 44 years of family management, Coach was sold to diversified food and consumer goods producer, Sara Lee.

Sara Lee's 1985 acquisition of Coach left the handbag manufacturer's strategy and approach to operations more-or-less intact. The company continued to build a strong reputation for long-lasting, classic handbags. However, by the mid-1990s the company's performance began to decline as consumers developed a stronger preference for stylish French and Italian designer brands such as Gucci, Prada, Louis Vuitton, Dolce & Gabbana, and Ferragamo. By 1995, annual sales growth in Coach's best-performing stores declined from 40 percent to 5 percent as the company's traditional leather bags fell out of favor with consumers.

In 1996, Sara Lee made 18-year-Coach-veteran Lew Frankfort head of its languishing handbag division. Frankfort's first move was to hire Reed Krakoff, a top Tommy Hilfiger designer, as Coach's new creative director. Krakoff believed new products should be based upon market research rather than designers' instincts about what would sell. Under Krakoff, Coach conducted extensive consumer surveys and held focus groups to ask customers about styling, comfort, and functionality preferences. The company's research found that consumers were looking for edgier styling, softer leathers, and leather-trimmed fabric handbags. Once prototypes had been developed by a team of designers, merchandisers, and sourcing specialists, hundreds of previous customers were asked to rate prototype designs against existing handbags. The prototypes that made it to production were then tested in selected Coach stores for six months before a launch was announced. The design process developed by Krakoff also allowed Coach to launch new collections

every month. Prior to Krakoff's arrival, Coach introduced only two collections per year.

Frankfort's turnaround plan also included a redesign of the company's flagship stores to complement Coach's contemporary new designs. Frankfort abandoned the stores' previous dark, wood-paneled interiors in favor of minimalist architectural features that provided a bright and airy ambiance. The company also improved the appearance of its factory stores, which carried test models, discontinued models, and special lines that sold at discounts ranging from 15 percent to 50 percent. Such discounts were made possible by the company's policy of outsourcing production to 40 suppliers in 15 countries. The outsourcing agreements allowed Coach to maintain a sizeable pricing advantage relative to other luxury handbag brands in its full-price stores as well. Handbags sold in Coach full-price stores ranged from \$200 to \$500, which was well below the \$700 to \$800 entry-level price charged by other luxury brands.

Coach's attractive pricing enabled it to appeal to consumers who would not normally consider luxury brands, while the quality and styling of its products were sufficient to satisfy traditional luxury consumers. In fact, a *Women's Wear Daily* survey found that Coach's quality, styling, and value mix was so powerful that affluent women in the U.S. ranked Coach ahead of much more expensive luxury brands like Hermes, Ralph Lauren, Prada, and Fendi.¹

By 2000, the changes to Coach's strategy and operations allowed the brand to build a sizeable lead in the "accessible luxury" segment of the leather handbags and accessories industry and made it a solid performer in Sara Lee's business lineup. With the turnaround successfully executed, Sara Lee management elected to spin off Coach through an IPO in October 2000 as part of a restructuring initiative designed to focus the corporation on food and beverages.

Coach Inc.'s financial results and stock price performance proved to be stellar, as evidenced by its quadrupled growth in annual sales from \$555 million in 1999 to more than \$4.2 billion in 2012, reflecting their success in identifying and capitalizing quickly on opportunities for growth. This was translated into earnings over the same timeframe from \$16.7 million to \$880 million. Though Coach Inc.'s share price had fallen dramatically at the beginning of the economic slowdown in 2007, it rebounded after its profitability improved in 2010.

Exhibit 1 presents Coach's income statements for fiscal 2007 through fiscal 2011. Exhibit 2 presents the company's balance sheets for fiscal 2010 and fiscal 2011. Exhibit 3 provides a review of Coach's stock price performance since October 2000.

EXHIBIT 1 Coach Inc.'s Consolidated Statements of Income, Fiscal 2007-Fiscal 2011 (in thousands, except share amounts)

	2011	2010	2009	2008	2007
Net sales	\$4,158,507	\$3,607,636	\$3,230,468	\$3,180,757	\$2,612,456
Cost of goods sold	1,134,966	973,945	907,858	773,654	589,470
Gross profit	3,023,541	2,633,691	2,322,610	2,407,103	2,022,986
Selling, general, and administrative expenses	1,718,617	1,483,520	1,350,697	1,259,974	1,029,589
Operating income	1,304,924	1,150,171	971,913	1,147,129	993,397
Interest income	1,031	7,961	10,779	44,639	41,273
Income tax	425,155	423,192	359,323	408,729	398,141
Net income	\$ 880,800	\$ 734,940	\$ 623,369	\$ 783,039	\$ 636,529
Dividends declared per common share	\$0.68	\$0.38	\$0.08	\$0.00	\$0.00
Net income per share					
Basic shares	\$2.99	\$2.36	\$1.93	\$2.20	\$1.72
Diluted shares	\$2.92	\$2.33	\$1.91	\$2.17	\$1.69
Shares					
Basic shares outstanding	294,877	311,413	323,714	355,731	369,661
Diluted shares outstanding	301,558	315,848	325,620	360,332	377,356

Source: Coach Inc. 10Ks, various years.

EXHIBIT 2 Coach Inc.'s Balance Sheets, Fiscal 2010-Fiscal 2011 (in thousands)

	July 2, 2011	July 3, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 699,782	\$ 596,470
Short-term investments	2,256	99,928
Trade accounts receivable (less allowances of \$9,544 and \$6,374, respectively)	142,898	109,068
Inventories	421,831	363,285
Deferred income taxes	93,902	77,355
Prepaid expenses	38,203	30,375
Other current assets	53,516	26,160
Total current assets	1,452,388	1,302,641
Long-term investments		
Property and equipment, net	582,348	548,474
Goodwill and intangible assets	340,792	315,649
Deferred income taxes	103,657	156,465
Other assets	155,931	143,886
Total assets	\$2,635,116	\$2,467,115
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 118,612	\$ 105,569
Accrued liabilities	473,610	422,725
Revolving credit facilities		
Current portion of long-term debt	795	742
Total current liabilities	593,017	529,036
Deferred income taxes		
Long-term debt	23,360	24,159

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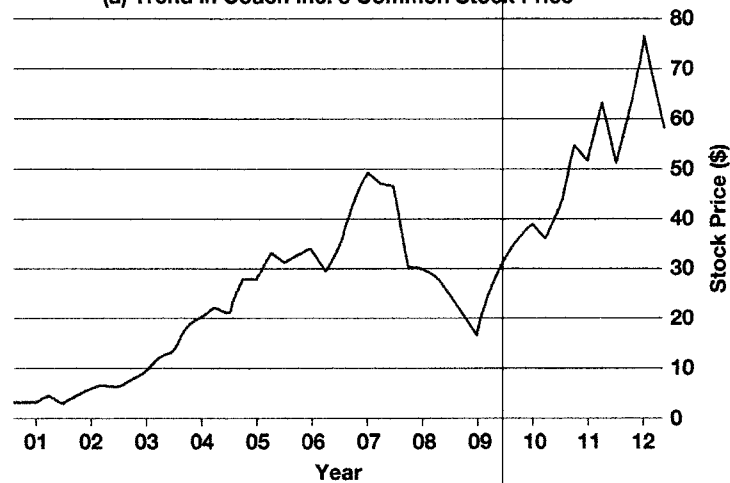
EXHIBIT 2 (Concluded)

	July 2, 2011	July 3, 2010
<u>Other liabilities</u>	406,170	408,627
Total liabilities	1,022,547	961,822
Stockholders' equity:		
Preferred stock: (auth. 25,000,000 shares; \$0.01 par value) none issued	—	—
Common stock: (authorized 1,000,000,000 shares; \$0.01 par value)	2,886	2,969
Issued and outstanding 288,514,529 and 296,867,247, respectively		
Additional paid-in capital	2,000,426	150,2982
Accumulated deficit	(445,654)	(30,053)
<u>Accumulated other comprehensive income</u>	54,911	29395
<u>Total stockholders' equity</u>	1,612,569	1,505,293
<u>Total liabilities and stockholders' equity</u>	\$2,635,116	\$2,467,115

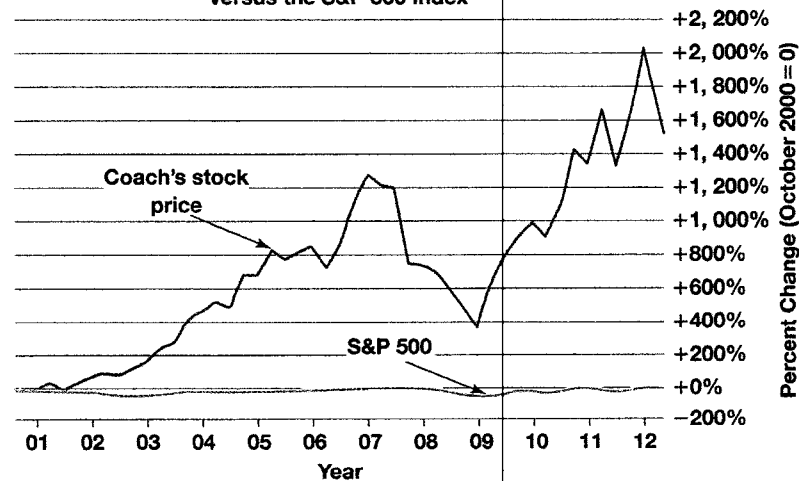
Source: Coach Inc. 2011 10-K.

EXHIBIT 3 Performance of Coach Inc.'s Stock Price, October 2000–June 2011

(a) Trend in Coach Inc.'s Common Stock Price



(b) Performance of Coach Inc.'s Stock Price versus the S&P 500 Index



OVERVIEW OF THE GLOBAL LUXURY GOODS INDUSTRY IN 2012

According to a 2011 Bank of America/Merrill Lynch study, the world's most well-to-do consumers spent more than \$224 billion on luxury goods in 2010. The U.S. represented 30 percent of industry sales, Europe accounted for 30 percent, 20 percent of industry sales were made in China, and Japan was responsible for 11 percent of total industry sales. Italian companies commanded 27 percent of industry sales, while French companies held a 22 percent share, Swiss companies possessed a 19 percent share, and U.S. companies accounted for 14 percent of industry sales. The most valuable luxury brands in terms of annual revenues in 2011 were Louis Vuitton, Gucci, Hermes, and Cartier. The handbag and leather accessories segment of the industry was estimated at \$28 billion in 2010 (see Exhibit 4).

The global luxury goods retail market was significantly affected by the economic slowdown and financial crisis of 2007–2009 as consumers in most income categories cut back on discretionary purchases. The poor general economic conditions created a 0.6 percent annual decline in industry sales between 2006 and 2010. However, while sales declined in the United States, Japan, and Europe, emerging markets, and especially China, became a key growth driver for the industry from 2006 to 2009. Continued growth in China and other emerging markets was expected to allow luxury goods sales to increase by 7.8 percent annually through 2015 to reach a staggering \$350 billion.

Luxury brands, in general, relied on creative designs, high quality, and brand reputation to attract

customers and build brand loyalty. Price sensitivity for luxury goods was driven by brand exclusivity, customer-centric marketing, and to a large extent some emotional sense of status and value. The market for luxury goods was divided into three main categories: haute-couture, traditional luxury, and the growing submarket "accessible luxury." At the apex of the market was haute couture with its very high-end "custom" product offering that catered to the extremely wealthy. Leading brands in the traditional luxury category included such fashion design houses as Prada, Burberry, Hermes, Gucci, Polo Ralph Lauren, Calvin Klein, and Louis Vuitton. Some of these luxury goods makers also broadened their appeal with diffusion lines in the accessible luxury market to compete with Coach, DKNY, and other lesser luxury brands. For example, while Dolce & Gabbana dresses might sell at price points between \$1,000 and \$1,500, under their D&G affordable luxury brand—dresses of similar appearance were priced at \$400 to \$600. Giorgio Armani's Emporio Armani line and Gianni Versace's Versus lines typically sold at price points about 50 percent less than similar-looking items carrying the marquee labels. Profit margins on marquee brands approximated 40–50 percent, while most diffusion brands carried profit margins of about 20 percent. Luxury goods manufacturers believed diffusion brands' lower profit margins were offset by the opportunity for increased sales volume and the growing size of the accessible luxury market and protected margins on such products by sourcing production to low-wage countries.

Industry sales in the United States had become more dependent on the success of diffusion lines in the accessible luxury category. Although primary traditional luxury consumers in the U.S. comprised the top one percent of wage earners with household

EXHIBIT 4 The Global Handbag and Accessories Market (dollar amounts in billions)

	U.S.	Japan	China	Asia (including Japan)	Other/Europe	Total
Sales	\$10.0	\$4.4	\$3.2	\$12.0	\$6.0	\$28.0
Share of market	36%	16%	11%	43%	21%	100%
Gender Mix Estimates						
Men's	15%	20%	45%	25%	15%	15%
Women's	85%	80%	55%	75%	85%	85%

Source: J.P. Morgan Analyst Report and Coach reports.

incomes of \$300,000 or better, those consumers that earned substantially less also aspired to own products with higher levels of quality and styling. The growing desire for luxury goods by middle-income consumers was thought to be a result of a wide range of factors, including effective advertising and television programming that promoted conspicuous consumption. The demanding day-to-day rigor of a two-income household was another factor suggested to urge middle-income consumers to reward themselves with luxuries. An additional factor contributing to rising sales of luxury goods in the United States was the "Trade up, trade down"² shopping strategy, whereby consumers would balance their spending by offsetting gains made with lower-priced necessities purchased at major retailers (e.g., Walmart and Target) to enable more discretionary spending available for indulgences on high-end product purchases.

The Growing Demand for Luxury Goods in Emerging Markets

Emerging markets, especially China and India, were expected to provide a major boost to the luxury goods market because of rapidly increasing wealth levels and standard of living gains. In 2012, 2.7 million individuals in China had a net worth of more than \$1 million, and 63,500 individuals had net worths of more than \$15 million. Luxury goods were also highly demanded by China's middle class, which allowed it to become the world's third-largest luxury market in 2010, with sales of luxury goods approaching \$32 billion. Luxury goods spending in China was expected to overtake that of Japan and the United States, making China the world's largest market for luxury goods by 2015.

This is a remarkable outcome considering the luxury market has only been in existence there since the 1990s. Prior to this time, market entry by outsiders was restricted by the Chinese government despite the so-called open-door policy and economic reform. However, this all changed around 2000, along with the rapid economic and social developments occurring in China, and a group of luxury brands, such as Chanel, Prada, and Dolce & Gabbana, entered the market. Others, like Coach entered with local distributors. From 2007 to 2010, the Chinese luxury goods market was one of the key growth drivers to the global luxury goods market, and the competition of luxury brands gradually moved from major cities to smaller-tier ones. In 2012, close to 1,000 store locations operated within the Chinese market under the brands of

approximately 25 leading luxury marketers. Leading the charge was Hugo Boss with 114 stores, followed by Armani with 104 stores. Coach was ranked eighth in luxury goods store locations in China with 52 stores.

Luxury goods producers were also opening retail stores in India, which was another rapidly growing market for luxury goods. India's booming economy had created a new class of "business maharajahs"—highly affluent and globalized professionals. To serve this consumer segment, some 60 global luxury fashion and accessories brands had begun selling their products in India, mainly through local franchise partners who manage the brand. However, this opportunity came with some distinct challenges. For example, sales of western women's clothing had struggled because Indian women still consider elaborate, highly crafted saris and other traditional items the garments of choice for formal occasions. Also, local designers such as Tarun Tahiliani and Satya Paul had more local brand recognition than some European or U.S. fashion houses. Watches, jewelry, and handbags, most of which have immediate brand recognition, fared better and accounted for the largest portion of luxury good sales in India.

Counterfeiting

It was estimated that between \$300 and \$600 billion worth of counterfeit goods were sold in countries throughout the world. European and American companies that produced highly sought after branded products were most vulnerable to counterfeiting, with fakes plaguing almost every industry. Fake Rolex watches or Ralph Lauren Polo shirts had long been a problem, but by the mid-2000s, counterfeiters were even making knockoffs of branded auto parts and prescription drugs. Counterfeiting had become so prevalent that the Global Congress on Combating Counterfeiting estimated that 9 percent of all goods sold worldwide were not genuine. About two-thirds of all counterfeit goods were produced by manufacturers in China and Asian countries.

Luxury brands have found it financially and operationally beneficial to team up to combat counterfeiters. Luxury brands such as LVMH and Estee Lauder had collaborated to develop best practices for measuring and implementing international piracy enforcement. LVMH and Apple teamed up and shared enforcement costs once it was discovered that counterfeit iPhone and iPad covers with LV logos were being produced—mutually gaining from their partnership.

COACH'S STRATEGY AND INDUSTRY POSITIONING

Coach offered distinctive, easily recognizable luxury products that were extremely well made and provided excellent value. The company's array of products included ladies handbags, leather accessories such as key fobs, belts, electronic accessories, and cosmetics cases, and outerwear such as gloves, hats, and scarves. Also, Coach designed and marketed leather business cases and luggage. It also expanded its accessories product offerings through licensing agreements with the Movado Group for Coach-branded watches in 1998, the Jimlar Corporation for Coach-branded ladies footwear in 1999, and Marchon Eyewear, Inc. for Coach eyewear in 2003. However, Coach entered into a licensing agreement with Luxottica in 2010 that would transition its eyewear products business beginning in the second half of 2012. The new agreement would expand its collection of prescription glasses and sunglasses marketed in Coach retail stores, at coach.com, in department stores, and select sunglass retailers and optical retailers in major markets. In spring 2010, Estee Lauder agreed to produce a fragrance for Coach that would be distributed through Coach retail stores, coach.com, and about 3,000 U.S. department stores. Coach offered four women's fragrances and one men's fragrance.

Handbags accounted for 63 percent of Coach's 2011 sales of \$4.2 billion, while accessories made up 27 percent. All other products accounted for 10 percent of company sales, which reflected a slight product mix change favoring the other product groupings since 2007, where the sales mix was 64 percent, 28 percent, and 8 percent, respectively. Royalties from Coach's licensing agreements with Movado, Jimlar, and Marchon accounted for approximately 1 percent of sales and was not a major contributor to overall earnings.

Coach positioned its brand in the lower part of the accessible or affordable luxury pyramid. This particular market provides a larger opportunity relative to that of more exclusive brands. Coach targeted the top 20 percent of Americans by household income, as opposed to the top 3 to 5 percent targeted by most European luxury brands. Coach had focused on sales in China, Japan, and the United States because these three countries lead global luxury goods spending. The company's sales in Japan had increased from \$144 million in 2002 to \$748 million in 2011, and its market share in the U.S. had nearly doubled since 2002.

During 2011, roughly 84 percent of Coach's total net sales (up from 75 percent in 2010) were generated from products introduced within the year. Given that the collections are seasonal and are planned to be sold in stores for short promotional periods of time, production quantities are limited, and are designed to minimize risks associated with owning inventory. Sales of Coach's products for men grew from about 2.5 percent to nearly 5 percent of its global business, increasing to more than \$200 million by 2011. Over time, Coach expected men's products to account for 15 percent or more of its global sales. The company's emphasis on dual-gender product offerings reflects the uptrend in the men's luxury goods market.

Flexible Sourcing

All of Coach's production was outsourced to contract manufacturers, with vendors in China accounting for 85 percent of its production requirements. Vendors located in Vietnam and India produced the remaining 15 percent of Coach's product requirements. Management controlled quality throughout the process with product development offices in Hong Kong, China, South Korea, India, and Vietnam. This broad-based, global manufacturing strategy was designed to optimize the mix of cost, lead times, and construction capabilities.

Approach to Differentiation

The market research design process developed by Executive Creative Director Reed Krakoff provided the basis of Coach's differentiated product line: Each quarter, major consumer research is undertaken to define product trends, selections, and consumer desires. This, together with the company's procurement process that selected only the highest-quality leathers and its sourcing agreements with quality offshore manufacturers, contributed to the company's reputation for high quality and value. Monthly product launches enhanced the company's vogueish image and gave consumers reason to make purchases on a regular basis. The company's market research found its best customers visited a Coach store once every two months and made a purchase every seven months. Research in 2006 suggested the average Coach customer purchased four handbags per year. Lew Frankfort said the increase was attributable to monthly product launches that "increase the frequency of consumer visits" and women's changing style preference of "using bags to complement their wardrobes in the

same way they used to use shoes.”³ A retail analyst agreed with Frankfort’s assessment of the importance of frequent product introductions, calling it “a huge driver of traffic and sales and has enabled them to capture the . . . customer who wants the newest items and fashions.”⁴ Seventy percent of Coach’s sales came from products introduced within the fiscal year. However, the company’s Coach Classics collection, which was made up of lighter-weight, updated versions of iconic Coach handbag designs from the 1970s and 1980s, was among its best-selling lines in 2012.

The aesthetic attractiveness of Coach’s full-price stores, which were designed by an in-house architectural group under the direction of Krakoff, further enhanced the company’s luxury image. The company’s stores significantly enhanced the Coach brand and was consistent with its strategy of raising awareness and aggressively growing market share. For example, a 9,400-square-foot store opened in 2012 featured an impressive four-story glass and stainless steel back-lit facade, as well as the Coach Horse and Carriage logo. Coach sought to make customer service experiences an additional differentiating aspect of the brand. It had agreed since its founding to refurbish or replace damaged handbags, regardless of the age of the bag. The company provided store employees with regular customer service training programs and scheduled additional personnel during peak shopping periods to ensure all customers were attended to satisfactorily. Through the company’s Special Request service, customers were allowed to order merchandise for home delivery if the particular handbag or color wasn’t available during a visit to a Coach store.

Coach also saw its communications with its customers as an opportunity for further differentiation. It communicated with customers through a wide range of direct marketing activities that included email contacts, websites, catalogs, and brochures. In fiscal 2011, Coach reported that consumer contacts increased 52 percent to over 625 million and was primarily driven by increased email communications. The company contact list included approximately 19 million active households in North America and 4.2 million active households in Japan. Also in 2011, Coach distributed approximately a million catalogs in its stores in Japan, Hong Kong, Macau, and mainland China.

Retail Distribution

Coach channels of distribution involved direct-to-consumer channels and indirect channels. Direct-to-consumer channels included full-price stores in the

EXHIBIT 5 Coach Inc.’s Retail Stores by Geographic Region, 2007-2011

	2007	2008	2009	2010	2011
North American retail stores	259	297	330	342	345
North American factory stores	93	102	111	121	143
Coach Japan locations	137	149	155	161	169
Coach China locations	16	24	28	41	66
Total stores	505	572	624	665	723

Source: Coach Inc., 10-K.

U.S., factory stores in the U.S., Internet sales, catalog sales, and stores in both Japan and China. Indirect sales included wholesale accounts with department stores in the U.S. and other international markets. Exhibit 5 provides the number of Coach retail stores by geographic region for 2007 through 2011. Exhibit 6 presents Coach’s net sales and operating income by channel of distribution for 2009 through 2011.

Full-Price Stores In 2011, Coach had 345 full-price retail stores in the United States, which comprised 70 percent of its total U.S. outlets. Full-price stores were divided into three categories—core locations, fashion locations, and flagship stores. Under Coach’s tiered merchandising strategy, the company’s flagship stores carried the most sophisticated and highest-priced items, while core stores carried widely demanded lines. The company’s fashion locations tended to stock a blend of Coach’s best-selling lines and chic specialty bags.

Coach’s site selection process placed its core and fashion stores in upscale shopping centers and downtown shopping areas, while flagship stores were restricted to high-profile fashion districts in cities such as New York, Chicago, Beverly Hills, and San Francisco. Even though flagship stores were “a beacon for the brand”⁵ as Frankfort described them, the company had been very prudent in the number of flagship stores it operated since such stores, by definition, were required to be located on the world’s most expensive parcels of real estate.

A further advance launched in 2010 was the Coach brand “Reed Krakoff,” created as a standalone entity with higher average price points than the Coach brand, with store openings initially planned for North

EXHIBIT 6 Selected Financial Data for Coach Inc. by Channel of Distribution, Fiscal 2009-Fiscal 2011 (in thousands)

	Direct-to-Consumer	Indirect Corporate	Unallocated	Total
FISCAL 2011				
Net sales	\$3,621,886	\$536,621		\$4,158,507
Operating income (loss)	1,423,191	296,032	\$(414,299)	1,304,924
FISCAL 2010				
Net sales	3,155,860	451,776		3,607,636
Operating income (loss)	1,245,400	256,637	(351,866)	1,150,171
FISCAL 2009				
Net sales	2,726,891	503,577		3,230,468
Operating income (loss)	996,285	290,981	(315,353)	971,913

Source: Coach Inc., 2011 10-K.

America and Japan to bridge the more traditional luxury market.

Factory Stores Coach had 143 factory stores by 2011. The company had placed an additional emphasis on factory stores since the onset of the economic downturn, with the number of factory stores increasing by about 9 annually between 2007 and 2011. Coach's factory stores in the U.S. were generally located 40 or more miles from its full-price stores. About 75 percent of factory store inventory was produced specifically for Coach's factory stores, while the remaining 25 percent was made up of overstocked items and discontinued models. Coach's 10 to 50 percent discounts offered in factory stores allowed the company to maintain a year round full-price policy in full-price stores. Coach CEO Lew Frankfort believed discounted prices were critical to success in retailing since 80 percent of women's apparel sold in the U.S. was bought on sale or in a discount store. "Women in the U.S. have been trained to expect to be able to find a bargain if they either go through the hunt . . . or are willing to buy something after the season," said Frankfort.⁶

Therefore, Coach's factory stores target value-oriented customers who might not otherwise buy a Coach product. Both factory store customers and full-price customers were equally brand loyal, but there was a distinct demographic difference between the shopper segments. The company's market research found the typical full-price store shopper was a 35-year-old,

college-educated, single or newly married working woman. The typical factory store shopper was a 45-year-old, college-educated, married, professional woman with children. The average annual spending in a Coach store by full-price shoppers was \$1,100. Factory store shoppers spent about \$770 annually on Coach products, with 80 percent spent in factory stores and 20 percent spent in a full-price store.

The factory store strategy capitalized on the brand's lead luxury image projected at their flagship and retail stores, and ensured it maintained its own individual identity so as not to dilute the foundation of the Coach brand. While the company had accelerated factory store openings, Frankfort did not want factory outlet stores to grow too rapidly since "Our destiny lies in our ability to grow full-price stores."⁷ Some analysts were worried that Coach's highly successful factory stores might someday dilute its image. A Luxury Institute analyst described the dilemma faced by Coach and luxury diffusion brands by commenting "To be unique and exclusive you cannot be ubiquitous."⁸

Coach Japan Coach sold their products in Japan in shop-in-shop department store locations, Coach full-price retail stores, and Coach factory outlets. The company had 169 retail locations in Japan in 2011, which generated \$748 million in sales. The company's management believed Japan could support as many as 180 Coach retail outlets. The Japanese luxury goods market has been flat to slightly growing

over the last several years, but Coach planned to drive growth in Japan by focusing on the market for men's luxury goods, which represented 25 percent of sales in the market in 2011.

Coach China Coach had 66 stores in China in 2012, up from 41 stores in 2011. The company had targeted 120 cities in China with populations of at least 1 million for future store openings. The majority of Coach's stores in China carried dual-gender product lines since about 45 percent of China's luxury market was men's products. The market for men's luxury goods represented about 15 percent of sales in the United States and 20 percent of sales in Japan.

Rivalry in the luxury goods industry in China was very intense, with 26 luxury goods brands operating 969 retail stores in the market in 2011. Hugo Boss had the largest number of stores in China with 114 stores, followed by Armani with 104 stores. In 2011, Gucci operated 45 stores in China, Prada had 14 stores, and Kate Spade had 5 stores in China. Coach anticipated recording fiscal 2012 revenues in China of approximately \$300 million.

U.S. Wholesale Coach's products were sold in approximately 970 wholesale locations in the U.S. and Canada. The most significant U.S. wholesale customers included Macy's (including Bloomingdale's), Dillard's, Nordstrom, Lord & Taylor, and Saks Fifth Avenue. Wholesale sales of Coach products to U.S. department stores increased by 5 percent per year during 2006 to 2011 to reach approximately \$300 million. However, department stores were becoming less relevant in the U.S. retailing industry with the average consumer spending less time in malls and shopping in fewer stores during visits to malls. The share of the U.S. retail market held by department stores declined from about 30 percent in 1990 to less than 20 percent in 2011.

International Wholesale Coach's wholesale distribution in international markets involved department stores, freestanding retail locations, shop-in-shop locations, and specialty retailers in 18 countries. The company's largest international wholesale accounts were the DFS Group, Lotte Group, Shila Group, Tasa Meng Corporation, and Imaginex. The largest portion of sales by these companies was to traveling affluent Chinese and Japanese consumers. Coach's largest wholesale country markets were Korea, Hong Kong, Taiwan, Singapore, Japan, Saudi

EXHIBIT 7 Breakdown of Coach Inc.'s Selling, General, and Administrative Expenses, Fiscal 2007–Fiscal 2011 (in thousands)

	2011	2010	2009	2008	2007
Selling	\$1,180	\$1,049	\$ 981	\$ 865	\$ 718
Advertising	224	179	164	148	120
Distribution	58	48	52	48	53
Administration	204	153	130	167	139
Administration adjustment	51	54	24	32	0
Total	1,718	1,483	1,351	1,260	1,030

Source: Coach Inc. 10-K.

Arabia, Australia, Mexico, Thailand, Malaysia, the Caribbean, China, New Zealand, and France. In 2006, international wholesale accounts amounted to \$147 million and have grown some 7.8 percent per year to reach approximately \$230 million in 2011. A breakdown of the company's selling, general, and administrative expenses for 2007 through 2011 are presented in Exhibit 7.

COACH'S STRATEGIC OPTIONS IN 2012

In 2012, Coach was evolving into more of a global growth-oriented company. Lew Frankfort's key growth initiatives involved store expansion in the U.S., Japan, Hong Kong, and mainland China; increasing sales to existing customers to drive comparable store growth, building market share in the men's market by introducing men's-only stores and building on the dual-gender store concept, and creating alliances to exploit the Coach brand in additional luxury categories. In addition, Coach was also considering opportunities to expand into the European luxury goods market. However, the company faced threats from prestigious European and North American luxury goods brands that had developed diffusion lines that carried price points similar to those offered by Coach. In addition, all of the world's major luxury brands were racing to establish a retail presence and

brand loyalty in China, India, and other developing countries that would soon account for a large percentage of industry sales. In addition to market-related threats, Coach management also needed to

consider how best to boost its profit margins to levels achieved in previous years and stabilize its stock price, which fell by nearly \$20 during the first six months of 2012.

ENDNOTES

¹ "How Coach Got Hot," *Fortune*, Vol. 146, Issue 8, October 28, 2002.

² As quoted in "Stores Dancing Chic to Chic," *Houston Chronicle*, May 6, 2000.

³ As quoted in "Fashions Keep Retailer Busy," *Investor's Business Daily*, February 10, 2005, p. A04.

⁴ *Ibid.*

⁵ As quoted in "Coach's Split Personality," *BusinessWeek*, November 7, 2005.

⁶ As quoted in "Coach Sales Strategy Is in the Bag," *Financial Times*, April 18, 2006.

⁷ *Ibid.*

⁸ As quoted in "Expansion into U.S.: Extending the Reach of the Exclusive Lifestyle Brands," *Financial Times*, July 8, 2006, p. 17.