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LVMH IN 2004: THE CHALLENGES OF STRATEGIC INTEGRATION

The correct strategy is to know where a particular brand is headed and the managers and teams of each brand must imagine that. Then, we watch what is done at the group level and we extract a number of learnings: what are the businesses to acquire, where do we have to invest to develop this or that brand to benefit the group as a whole.

—Bernard Arnault, Chairman and CEO, LVMH Moët Hennessy Louis Vuitton[1]

INTRODUCTION

LVMH was created in 1987 in Paris, France through the merger of Louis Vuitton, the upscale luggage company and Moët Hennessy, leading producer of champagne and cognac. Since its merger, LVMH stood out as a leader in the $60 billion luxury goods industry. By early 2004, it had grown to over 50 brands sold in more than 100 countries around the world and generated more than €12 billion in sales. In the past decade, its strategy had yielded 15 percent yearly growth in revenue, of which 9 percent had been achieved through organic growth.[2] The company had achieved a dominant position in champagne, cognac, fashion and leather goods, and selective retailing; and a top tier position in perfumes and cosmetics, as well as watches and jewelry.[3]

Despite facing the toughest environment for the luxury goods industry since its founding over 15 years ago, the company delivered strong results for 2003, reporting a 30 percent increase in net income in 2003 **(Exhibit 1)**. Most of the increase was driven by efficiencies at the brand level, disposition of non-strategic brands and a successful hedging policy. Some groups performed well, including Moët Hennessy, the wines and spirits division, the perfume and cosmetics group and Louis Vuitton, the luggage group. (The performance of the latter was particularly impressive given that the rest of the industry—Hermes and Gucci in particular—were

[1] Bernard Arnault, Interview with Yves Messarovitch, "La Passion Creative," Plon, September 2001.
[2] "LVMH: Hardly Growth Through Acquisitions," Lehman Brothers Global Equity Research, July 2002.
[3] LVMH, Presentation to Shareholders, 2002.

Federico Antoni (MBA 2004) prepared this case under the supervision of Professor Robert A. Burgelman and Philip Meza as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

struggling.) However, LVMH's fashion houses and the Watch and Jewelry businesses were still going through difficult times. Overall, the results showed signs of recovery in the American and Asian markets for the second half of the year in 2003, and perhaps the end of the global downturn for the industry.

Collectively, LVMH's stars shone brightly, and profitably in early 2004. The Louis Vuitton luggage group, in particular, showed stellar results. Its sales were estimated to have grown by 16 percent to $3.8 billion in 2003, it enjoyed a 45 percent operating margin, and its performance was viewed as the major driver of the doubling of LVMH's stock price to $75 between March 2003 and March 2004.[4] These figures were well ahead of the competition. For example, Italian luxury good maker Prada earned only $1.95 billion in sales, which were flat from 2002, with an operating margin of 13 percent. The Gucci fashion division of the Gucci Group earned $1.85 in sales, which had fallen 1 percent from 2002, with an operating margin of 27 percent. French luxury competitor Hermès earned $1.57 in sales in 2003, up 7.7 percent, and had an operating margin of 25.4 percent. American luxury goods company Coach earned $1.2 billion in 2003, a 34 percent increase over 2002, with an operating margin of almost 30 percent.[5]

Nevertheless, in early 2004 the company faced several strategic challenges associated with its growing complexity. Since 1997, there had been several attempts to achieve greater operational and strategic integration between the different businesses and brands. After several years of experimenting with a new organization structure to achieve the integration objectives, Patrick Houel, chief financial officer of LVMH since 1987, thought it was time to review the results and the tradeoffs that it imposed, to make sure the company was optimally structured to meet the strategic challenges ahead. Houel had seen other crises; but the group, diversified since its beginning, had shown an extraordinary resilience to challenges. During the worst periods, it had gained market share, found efficiencies and profited from opportunities to grow.

BUILDING OF A LUXURY EMPIRE

During a period of 15 years, LVMH created exceptional value and accumulated the most valuable portfolio of luxury brands in the world. Bernard Arnault, chairman and CEO since 1988, was the architect of this success. Educated in the prestigious French engineering school, *Ecole Polytechniques*, he began his career in the family business, Ferinel, a medium-sized construction company based in the North of France—an unexpected background for the future "Pope of Fashion," as the fashion press calls him.[6] (**Appendix I** describes the evolution of the luxury goods industry.)

[4] Carol Matlack, Rachel Tiplady, Diane Brady, Robert Berner and Hiroko Tashiro, "The Vuitton Machine," *Business Week*, March 22, 2004, pp. 98-102.

[5] Ibid

[6] Bernard Arnault owns 47 percent of stockholder's equity and 57 percent of voting shares. Since 1988, he has exercised control over the luxury conglomerate and its board. An example of this control was the appointment of his 28 year-old daughter, Delphine Arnault, as a permanent member of LVMH's board of directors in October 2003.

1987: Marrying Well. At the time of the 1987 merger between Moët Hennessy and Louis Vuitton, Patrick Houel remembers telling a reporter, "We've made a brilliant marriage."[7] Houel led merger negotiations and was the strongest supporter of the deal. The new conglomerate would group together the champagne and cognac houses and fragrance company Parfums Christian Dior, Loewe, and the Spanish fashion brand; owned by Moët Hennesy; Parfums Givenchy; and Louis Vuitton fashions of the Louis Vuitton group.

The French press went along with Houel's description:

> It was, the French press exulted, the marriage of the century. The aristocratic alliance had everything that a newlywed could dream of—champagne, fine cognac, heady perfumes, roses, expensive luggage. Rich, beautiful and ambitious, the partners were ideally suited in taste and temperament. And, although it had been the briefest of courtships, their families, among the most venerable industrial dynasties in France, could hardly disapprove. If the union of Louis Vuitton and Moët Hennessy bears expected fruit, they will be able to continue popping corks for a very long time to come.
>
> This merger creates a new and dashing kind of corporate animal: the first real multinational of world scale in top-of-the-line luxury goods. Determinedly French in both products and management style, LVMH (Moët Hennessy Louis Vuitton) has at a stroke redefined a bunch of small and fragmented industries into a coherent and growing sector, which smart footwork has put it into a good position to dominate.[8]

1988 to 1997: Building the Portfolio. The idea of combining apparently disparate businesses under the logic of *métiers*[9]of luxury and lifestyle was praised by some, but perceived as a sure fiasco[10] by part of the business community **(Exhibit 2)**. Bernard Arnault, who had bought the state-owned Christian Dior Couture three years earlier, saw on the contrary a great opportunity and adhered completely to the idea behind grouping luxury-goods brands. At the time of the merger, LVMH had 10 brands, including Parfums Christian Dior, Hennessy and Louis Vuitton, and over $1 billion in sales with champagne and cognac as its major activity.[11] Still controlled by the heirs of the founding families, conflicts and power struggles between Alain Chevalier (Moët) and Henri Racamier (Vuitton) soon overcame the initial enthusiasm of the merger. In 1988, Arnault jumped at the opportunity to acquire a majority stake, with the ambition of creating the largest conglomerate of luxury brands in the world. In a rare interview, Bernard Arnault said:

> It was a fantastic opportunity to group several companies with a potential that wasn't previously perceived. People didn't see luxury-goods businesses in the way they do today. Their valuations were by the way much lower at the time. Building a group like LVMH today would be impossible given the valuations

[7] Simon Caulkin, "A Multinational de Grand Luxe," *Management Today*, November 1987, p. 41.
[8] Ibid.
[9] *Métiers* is the French word for trade. It also refers to a vocation, an area of activity in which one excels.
[10] Simon Caulkin, ibid.
[11] Stephane Marchand, "Les Guerres du Luxe," Fayard, May 2002.

> attained by companies of the industry and the small number of "star brands" still available. I believe my team and I saw that potential before others.[12]

After a decade under Arnault leadership, sales more than tripled and operational income was multiplied by 2.5 times. LVMH added new brands to its exclusive portfolio. It acquired the fashion house Givenchy (1988), champagne maker Pommery (1991), fashion designer Berluti (1993), fashion designer Kenzo (1993), perfume maker Guerlain (1994), jeweler Fred (1995), fashion designer Celine (1996). It founded the Haute Couture brand under the name of its creator, Christian Lacroix in 1993. With its acquisitions, LVMH entered new sectors such as shoes with Berluti and jewelry with Fred. Of all the brands, Louis Vuitton stood out from the rest. By taking advantage of the financial strength and international leadership of LVMH, it spearheaded the big trend of the democratization of luxury. After 10 years, LVMH was the undisputed leader and the only large conglomerate in the industry. Arnault's vision was fulfilled. He was even credited with inventing the industry.[13]

1997 to 2001: Transformation Years. After 10 years of growth, the luxury empire had exceptional cash flows and quickly became a favorite of the investing community. Just when Wall Street's analysts were getting used to the grouping logic at LVMH, it decisively entered the selective retailing arena by acquiring Duty Free Shoppers and Sephora in 1997. This new activity became the most important of the group in terms of sales, with 30 percent of 1997 sales.[14] The following three years, LVMH continued its acquisition spree and entered a new sector of the industry—watches. Pierre Mallevays, director of acquisitions of LVMH, explained:

> We acquire companies in industries we understand. In the case of the watch industry, we had prior experience with Christian Dior and felt it was an important moment for the industry. Some companies, such as Richemont and Swatch Group, were consolidating the industry and we had noticed that it was almost impossible to create a successful brand in the high end of the industry. We felt that it was the time or never to get in the sector and we acquired complementary brands in the high end of the spectrum: Tag Heuer, Zenith, Chaumet and Ebel.[15]

It also consolidated its leadership in its traditional areas of operation: adding Fendi (1999), Thomas Pink (1999), Emilio Pucci (1999) and Donna Karan (2000) to the Fashion and Leather Goods portfolio. It extended its retail activity with Miami Cruiseline (2000) and Lamaritaine (2000). To its wine and spirits division, the conglomerate added two industry icons: Krug and Chateau d'Yquem founded in the 19th and 17th century, respectively. Finally, LVMH achieved a stronger presence in the U.S. for its Perfumes and Cosmetics by acquiring American start-ups: Bliss, Hard Candy, Benefit Cosmetics, and Make Up For Ever.

By 2000, LVMH had more than €12 billion in sales and a portfolio of more than 50 brands and had entered two new sectors of the industry. As a result of the acquisitions, the consolidated balance sheet for 2001 carried more than €4 billion in goodwill and brand assets with Tag Heuer,

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[12] Bernard Arnault, Entretien avec Yves Messarovitch, "La Passion Creative," Plon, September 2001.
[13] Ibid.
[14] LVMH, Annual Report, 1997.
[15] Author's interview, July 2003.

Fendi and Donna Karan New York brands valued at €837, €809, and €460 million, respectively. The stock attained its maximum valuation in August 2000 at €98.70 per share, nearly €50 billion of enterprise value.

2001 to 2003: a Sour Start for the New Millennium. The millennium started with reports on the disappointing sales of champagne for the New Year festivities. The environment for the luxury-goods industry was about to become the worst since the creation of LVMH. The depressed financial markets and the slowdown in the world economy were particularly difficult conditions for LVMH. Additionally, they had to absorb the impact of the dramatic events of 9/11 on worldwide tourism and on the Asian economy, the Iraq war, and SARS. The diversification of activities and regions that had allowed LVMH to overcome previous crises was not useful in the face of a global slowdown.

Not only was the environment difficult, but also LVMH needed to deliver on all promises of financial success from recent acquisitions, in order to justify each valuation. Sales stagnated around €12 billion between 2000 and 2002 and the group barely broke even in 2001. The stock price was valued as low as €28.40 euros in 2001 and floated around €40 during the first three years of the new millennium **(Exhibit 3)**. The sectors of Selective Retailing and Watches and Jewelry were hardly affected. LVMH restructured these divisions, closing unprofitable stores and reducing overheads. It also sold "non-strategic assets": Pommery, Hard Candy and Urban Decay. The investments were strictly limited to profitable and growth brands such as Louis Vuitton and Parfums Christian Dior. These "star brands" were key to helping LVMH weather difficult times for the industry. (**Appendix II** provides further detail on some of the brands in LVMH's portfolio.)

THE CHALLENGES OF STRATEGIC INTEGRATION

Brand-centric Strategy

From the start, the organization of the conglomerate had been designed around the brands **(Exhibit 4)**. Management principles of entrepreneurship and creativity gave almost complete independence to the teams in charge of the brand. The fact that LVMH owned brands that competed head-to-head was proof of this commitment to affiliate independence. Several executives emphasized the value of this independence. One senior executive pointed out that the tradition and vision lie with the brand; that the brand generates the energy and motivation. Consequently, cost cutting efforts or the pursuit of potential cross-brand synergies should never jeopardize this brand independence. The currency of the luxury goods business is dreams and emotion. These are the ingredients that make the brand. It is all a matter of the heart and the gut. Hence, the executives in charge of the brands need to be emotionally involved. They need to put together the best management team for the brand and then make sure to use the best practices and capabilities available within the company.[16]

[16] Author's interviews with LVMH executives.

Strategic Planning

The process of setting the strategy within LVMH reflected the brand-centric culture. The brand president was responsible for setting the strategy for its brand. Every year in June, brands presented a three-year plan to headquarters. The headquarters then recommended adjustments to the strategy if necessary before the strategic plan was approved. The creative, marketing and product dimensions of the strategic plans were reviewed on a case-by-case basis, ranging from close supervision to hands off approach, depending on the brand. Headquarters were very involved in deciding and assigning financial resources towards the implementation of the strategic plans. Brand presidents needed to justify any investment proposition and competed for financial resources with the rest of the brands.

The ongoing budgetary processes also shaped the allocation of financial resources. Each year the annual budget was proposed in November and received immediate feedback from headquarters. An agreement was reached before the end of the year. The budget underwent two revisions on the budgets in June and September. Beyond this process, LVMH appeared to be very flexible in this respect. By being open to market opportunities and adjusting to changes in environment, it further empowered the brands and their managers.

Organization Design for Strategic Integration

In 1987 the group had $1.3 billion in sales and fewer than 10 brands. For a decade the decentralized structure was maintained and the finance teams were responsible for identifying synergies and integration opportunities. These opportunities, usually found during audit and control activities, were implemented at different levels of the organization depending on the nature of the integration needed. But as LVMH added more brands and activities to its portfolio, the organization became more complex and opaque. The flipside of the organizational bias toward decentralization was that affiliates missed synergy opportunities and some of the value created by the size of the conglomerate. Well aware of these opportunities and pressured by the Asian crises, LVMH started in 1997 to create business branches around the different métiers of the firm.

Strategic integration could no longer be established by an informal dynamic, and was gradually institutionalized. It started with the integration of the Perfume and Cosmetics branch in 1997. A branch president was designated to take on the responsibility of integrating the companies while maintaining their independence. The branch structure would allow for the full exploitation of economies of scale, growth opportunities for smaller brands and back-office cost reduction. In 1999, LVMH created the Fashion group and the Watches and Jewelry branch. Moët Hennessy, the Wines and Spirits branch was already integrated to the extent possible given the constraints of the champagne and cognac industry. The Selective Retail arm maintained a completely decentralized structure. Patrick Houel commented on this initiative:

> Synergy exploitation and strategic integration are counter-cultural at LVMH. We believe so strongly in our brands and the respect of their values and identity that we have a strong bias for a decentralized structure. The reason we created these branches is to force ourselves to integrate our affiliates around the logic of

> *métiers*. We felt the need to profit more from the synergies and growth opportunities inside the group. The company has grown so much in the past 10 years, both in size and complexity that we needed to institutionalize this effort. It doesn't mean we are forgetting our strong belief in the independence of the houses; we are just taking full advantage of our leadership position.[17]

THE NEW BUSINESS BRANCHES

To complete the reorganization, LVMH designated a branch president to implement the branch strategy and coordinate integration efforts. This new position was also meant to lighten the number of units reporting directly to Bernard Arnault, which had significantly increased due to the wave of acquisitions at the end of the1990s. The branch president was regarded as a 'coach,' so to speak, for the brand management teams.

The branch organization grouped companies facing the same competitive environment and managing similar cost structures. These specific features determined the strategic integration opportunities—economies of scale—as well as the risks involved with their implementation, primarily stemming from diseconomies of scale. Additionally, constraints brought by minority interests and legal structures added complexity to integration efforts. (See **Exhibit 5A through 5C** for information concerning LVMH's competitors.)

Perfumes and Cosmetics

'A Communication and a Formula.' LVMH had several competitors for its Perfume and Cosmetics business: multibrand players such as L'Oreal with $3.6 billion in sales for its luxury products division - brands such as Lancôme, Ralph Lauren and Armani—and the American Estee Lauder with brands such as Clinique, Estee Lauder and Tommy Hilfiger. Other competitors focused on a single brand such as Chanel also competed for the $23 billion prestige perfume and cosmetics market.[18] Marketing and R&D were the largest cost drivers and the key success factors for the industry. The brand and its personality were paramount. The notoriety and strong identity of fashion houses were often levered to launch a perfume or cosmetics line. Ralph Lauren, Christian Dior, Chanel or Hermès capitalized on their brand names to sell bottled fragrances or beauty formulas. Jacques Mantz, CFO of Parfums Christian Dior, explained the nature of the relationship with Christian Dior Couture:

> The relationship with Dior Couture is extremely important. All the communication and what happens around the Haute Couture brand helps our division and the broad presence of the perfumes in selective retailers around the world supports the Dior couture brand. We need to work with coherence and coordination but respecting the differences of the nature of the activities. Dior Couture needs a flexibility that we, at the perfumes, do not have and the volatility of the couture division is not something we wish for the perfume division. John Galliano and Hedi Slimane, Christian Dior Couture creative directors, are very

[17] Author's interview, September 16, 2003.
[18] Estee Lauder, Q2 03 Conference Call Highlights, Merrill Lynch, January 2003.

> involved in specific perfume and cosmetic projects participating in all stages from the conceptual stage to the advertising photo shoot.[19]

Perfume and Cosmetics Branch. The implementation of the new organizational structure started with the Perfume and Cosmetics branch. Due to the nature of the activity, the strategic integration of the affiliates was a logical step to enhance the competitive position of the perfume houses. The newly formed structure quickly centralized R&D teams from Givenchy, Christian Dior and Guerlain, a particularly important initiative for the cosmetics business. To take more advantage of its size as the third largest perfume and cosmetics company in the world, purchases of supplies were also centralized. Additionally, critical services such as legal support for intellectual property and finance were merged into the shared service centers.

Despite the cost advantages of integrating the companies, LVMH was careful not to disturb the development and identity of the brands. It maintained independent production sites, and did not establish common production planning. Moreover, brands that had rarely negotiated together with department stores and duty free shops before the integration did not alter their commercial structures. Jacques Mantz commented on this particularity:

> It is seldom the case where the Perfume and Cosmetics branch is unified when negotiating distribution contracts. Each brand manages the relationship and negotiation processes with our clients even though all share them. We do have communication among the brands of the groups but the collaboration stops there. The group does not use its bargaining power to impose new brands [on] our clients, for instance. The new brand has to prove itself and gain the necessary legitimacy to gain access to distributors.[20]

The American Start-ups. Between 1998 and 1999 Patrick Choel, president of the Perfume and Cosmetics branch, spearheaded the initiative of acquiring niche cosmetics brands in the U.S.: Bliss, Hard Candy, BeneFit, Fresh, and Urban Decay. These American startups were part of a very successful breed of entrepreneurs that had entered the cosmetics industry with niche strategies in the 1990s. Along with LVMH, other industry heavyweights such as Estee Lauder and Shiseido acquired these energetic new brands.[21] Jacques Mantz explained:

> Recently, after setting up the Perfumes and Cosmetics branch, we found the need [for] engines of growth to relay our core brands in the medium term. We acquired five young American companies, very innovative and fast growing. These acquisitions reflected the strategic intent of LVMH to diversify development opportunities from French brands and to create an important pool of brands in the U.S. market.[22]

LVMH maintained the founding managers as heads of the companies. They would retain creative control and a minority stake, between 20 and 40 percent of the equity. The purpose of this policy

[19] Author's interview, July 2003.
[20] Author's interview, July 2003.
[21] Estee Lauder acquired MAC, Stila and Le Mer and Shiseido took over Nars.
[22] Author's interview, July 2003.

was to keep the creative and growth momentum of these brands. LVMH would support and accelerate their development within its international infrastructures, with support from Shared Service Centers and access to capital. The entrepreneurs would be able to cash part of their equity and increase substantially the potential of their brand. Jean Ford and Jane Ford-Danielson, founders of BeneFit, explained days after the transaction was confirmed:

> We are delighted to have concluded this exciting transaction with the perfect partner for BeneFit. LVMH won us over by being such a dedicated and respectful owner of branded consumer businesses, a very supportive shareholder and a keen proponent of international expansion. All of us at BeneFit are thrilled at the opportunity to combine LVMH's outstanding expertise and global reach with a whimsical and uniquely American brand like BeneFit. Together, we will deliver a definitive blend of the most innovative products in the international marketplace.[23]

This endeavor had mixed results. In 2002, Fresh and BeneFit recorded double-digit growth. BeneFit posted a 23 percent increase in revenues for the first half of 2003. On the other hand, LVMH decided to disinvest Urban Decay and Hard Candy in 2002 "to focus on the successful entrepreneurs." Some believed the contrasted results of the American startups within LVMH were explained by entrepreneur's capacity to maintain the momentum of their companies and to leverage the support of the group's central services and other resources. Companies with a management team that understood how to take advantage of being part of LVMH were doing better. On the other hand, when the current management was not able to unleash the potential of the partnership with the luxury goods giant, the combination did not deliver on its promise.[24]

Moët Hennessy. To carry the name, champagne and cognac have to be produced and bottled in specific regions of France. The Cognac region covers over 200,000 acres along the Charente River and may be distinguished by six different viticulture areas, or 'crus'. The blending, or "marriage", of these distinct qualities will confer to each cognac its individual and unique character. Champagne, whose surface area stretches over some 34,000 acres, is also obtained by blending different wines. As opposed to wine where each year's harvest can yield different flavors, champagne and cognac houses need to maintain a constant flavor achieved by combining wines of different years and viticulture areas. A consequence of the unpredictable nature of wine production is that champagne and cognac houses must carry large inventories to assure at least a minimum level of production and quality.

> In addition to the origin constraint, strong unions and government intervention characterize the industry. A history of several centuries shapes a very diverse competition in the wine and spirits markets. A Moët Hennessy executive commenting on the consequences of non-market forces of the industry, explained how unions had been important historically and would never allow an integration of administration services, not to mention production or harvest. Given the strong bargaining power of unions, LVMH avoided any risk of labor conflict.[25]

[23] Cosmetics International Website, October 10, 1999.
[24] Author's interviews with LVMH executives.
[25] Author's interviews with LVMH executives.

Moët Hennessy led the champagne and cognac industry with the most prestigious brands and one of the best distribution networks. It had been managed as a consolidated branch since the founding of LVMH. Worldwide leader of alcoholic beverages and 34 percent owner of Moët Hennessy, Diageo[26] was an indispensable partner for Moët Hennessy. A distribution alliance between the two companies gave their common commercial teams the world's premier portfolio of high-end brands: Hennessy Cognac, Dom Perignon Champagne, Johnnie Walker Whisky and Smirnoff Vodka were among the brands managed by the alliance. The two European partners obtained an enhanced bargaining power with its clients and economies of scales in the important markets—U.S., Japan, and Europe—and hence higher operating margins. This cost structure imposed limits to any attempt of strategic integration in the sector: the weight of overhead costs and dry supplies was so small that the added operational complexity resulting from trying to take advantage of synergies overshadowed the potential gains. When integrating companies, the added complexity needs to be justified with big savings. That is why companies in Moët Hennessy were very independent. One executive explained, using the example of Moët Chandon and Veuve Cliquot. They were door-to-door neighbors in the Champagne region, but had different accounting services and human resources divisions.[27]

Fashion and Leather Goods

Les Créateurs. The fashion industry is design-driven and volatile. The industry leaders in the luxury sector can rarely keep their positions, as new fashion gurus constantly emerge. Only a handful has managed to maintain their trend-setting status and most have lived between success and decline. (Although the Italian and French houses still enjoy a certain reputation, other countries have gained ascendance in the industry: Americans, English, Germans and Japanese have positioned powerful global lines. Ralph Lauren, Burberry, Hugo Boss and Issey Miyake are among the most profitable brands in the world.)

Most named after their first 'créateur', the fashion houses have imposed a style with a personality by intensive interaction with events, fashion shows and advertising. They have mastered the art of marrying creativity and marketing. The American Tom Ford and the English John Galliano are two examples of the influence of creative directors in the industry. Tom Ford, probably the best marketing director of all designers, was essential to the success story of Gucci in the 1990s.[28] John Galliano revolutionized Christian Dior with his outrageous collections that shocked and fascinated the fashion world. He was pivotal to Dior's turnaround. Behind these two designers, two businessmen transformed creativity into profitability: Bernard Arnault, chairman of Christian Dior Couture and LVMH and the Italian Domenico De Sole, chairman of Gucci.

The Fashion Group. Two years after the Perfume and Cosmetics branch was formed, it was the turn for the fashion houses to integrate into an activity branch. With 12 of the most famous

[26] Diageo was created in 1997 with the merger of Guinness, original shareholder of Moët Hennessy, and GrandMet. It became the largest producer of alcoholic beverages in the world with brands such as J&B, Smirnoff and Guinness. LVMH's proposal to include Moët Hennessy in the merger agreement was not accepted by the other parties.

[27] Author's interviews with LVMH executives.

[28] In November 2003, Gucci announced the departure of designer and artistic director, Tom Ford and CEO, Domenico De Sole. The following week, analysts discounted their share price estimates as much as 15% (JP Morgan estimates). Given the market capitalization of Gucci, that represents nearly €1.5 billion.

brands of the industry, the fashion group employed 19,000 workers, operated 15 factories and nearly 500 stores worldwide in 1999. Its integration was aimed to take advantage of the considerable size of this branch of LVMH's activity. In particular, sourcing offered a major opportunity for cost reduction: the fashion group acquired leather centrally as well as ready-to-wear fabric, and it acquired Rosimoda to produce shoes for Pucci, Berluti and Louis Vuitton. Bertrand Stalla-Bourdillon, managing director of Louis Vuitton described the integration efforts:

> The integration of the fashion houses into an activity branch was aimed at taking full advantage of our size and capabilities in the face of a market consolidation and increased competition of brands with similar strategies. The brands maintained full control of design and marketing, all activities essential to their culture and identity. We created coordination on the retail development between the brands in order to be the more efficient on space negotiations. We centralized some of the sourcing activities and shared technical and industrial knowledge across all the houses. That helped us reduce the costs of goods sold substantially. We also created the Shared Service Center that consolidated functions of information technology, human resources and control. We also increased the internal mobility of our managers with monthly human resources committees.[29]

Watches and Jewelry

Competitive Environment. Three players dominated the high-end segment of the industry. In the second half of the1990s, they consolidated the major brands of the industry after a wave of acquisitions. Swatch Group, Richemont and LVMH competed for the best names and built powerful portfolios. They soon started consolidating back office activities to reduce operating costs, and investing in new store openings and advertising. They reinforced their management teams. But the economic downturn in 2001 prevented them from enjoying any result for their efforts. A reflection of the industry malaise was the write-off that the Groupe Richemont undertook at the beginning of 2003. It wrote off $4 billion worth of the goodwill it had amassed during the end of the1990s.

Another big trend in the industry that further complicated things for the industry leaders was the entrance of fashion and leather goods brands. Yves Saint Laurent of the Gucci Group, Louis Vuitton, Mont Blanc and Prada (IWC) launched new collections of watches. Relying heavily on third-party distribution, this trend accentuated the crises of the industry. In addition, the industry had lead times for new product development of up to two years. Hence it was slower to react to adversity.

[29] Author's interview, September 2003.

Watches and Jewelry Branch Out. Watches and Jewelry was the latest activity in the LVMH portfolio. The acquisition of the different brands happened at the end of the 1990s and they were structured as a branch since the beginning. The branch pursued synergies in fields of product development, sourcing, production and distribution. Tag Heuer, the more dynamic brand, opened its first store in an effort to position the brand and test a concept that would allow the company to have more control of its distribution. The activity was still in an investing mode as the companies' initiatives took time to yield results.

Selective Retailing. Selective Retailing is LVMH's largest activity in sales and also the most challenging for the luxury specialist. It owns the cosmetics and perfume retailer, Sephora; two travel retail companies, Duty Free Shoppers and Miami Cruise line; and two department stores in Paris, Le Bon Marche and La Samaritaine. Some of them were acquired at the peak of the financial bubble of the end of the 1990s, and were heavily hit by the effects of 9/11 and SARS on travel. For example, in 2002, DFS had revenues that were half of what it generated when LVMH acquired the company. These companies were managed as independent entities and rarely participated in the dynamic of the rest of the group. The integration was limited to some positive spillovers on real estate issues and access to capital. The nature of the businesses, and some minority interest in the case of DFS, prevented further integration.

In 2002, Bernard Arnault announced that some selective retailing assets were no longer strategic and that LVMH would wait for better market conditions to dispose of the assets. The investment communities, that "hate the retail business"[30] of LVMH, received the news with approval. In 2003, LVMH's position had changed and the company no longer foresaw the disposal of this investment. The success of Sephora in the U.S. and the anticipated end of the crises in the travel industry were part of the arguments to maintain this activity.

LEVERAGING CORPORATE STRENGTH

Corporate synergies

Beyond the organization around *métiers* that respects the differences between the activities, important synergies were pursued at the corporate level. They were aimed to profit from the considerable size of the conglomerate and to give a competitive edge to its affiliates.

Advertising. Advertising was central to most of the affiliates' success. LVMH spent more than €1 billion euros in advertising or around 11 percent of sales in 2002. That made it the largest advertising buyer for fashion magazines, and an important client for other media outlets. A communication service at the corporate level was responsible for all negotiations with media companies and advertising agencies. This consolidation resulted in better prices for media spaces and a great capacity to promote brands and communicate product innovations. An illustration of the value brought by LVMH occurred in the recent acquisition of the American fashion brand,

[30] John Wakely, "LVMH: Good Franchises Can Get Oversold," Lehman Brothers, October 1998.

Donna Karan. While the advertising reach and media presence was maintained after the acquisition, the total cost of the advertising campaign was reduced by more than 20 percent.[31]

International Development. The luxury-goods industry has a tradition of international development and LVMH carried this tradition to the next level by helping its brands become global efficiently and fast. When a regional brand went global, it benefited from administrative and legal support and local culture knowledge. Depending on the activity, the brand might take advantage of commercial relationships already established, real estate knowledge and leverage for store openings, as well as a rich pool of experiences and human capital in particular markets.

The development of LVMH in Japan, Asia's largest luxury-goods market, is a good example of the development of brands internationally. Through the years, LVMH has earned a reputation as a hard negotiator of store leases. With 47 Louis Vuitton stores, the group obtained the best conditions and locations in the Japanese market. In September 2003, for instance, LVMH announced the store openings for the rest of the year[32] and most of them would be established in Japan: three new stores for DeBeers in line with company's plans, new stores for Celine, Loewe, Fendi and Donna Karan in Omotesando, a new Berluti in Osaka, and finally a new Givenchy in Tokyo.

Financial and Legal Services. Financial and legal support took place at different levels in the organization, depending on the activity. Most corporate finance and accounting activities happened at the affiliate and branch levels, but some of the key functions were centralized. The LVMH finance team was in charge, for instance, of the critical mission of protecting the affiliate companies against fluctuations in foreign currencies. Merrill Lynch has characterized this policy as "the best hedge covers in the industry."[33] Affiliates and branch organizations counted on LVMH headquarters for accounting services, legal, tax and financing activities. An executive commented on the benefits of centralized services:

> We have an exceptional team supporting us. For example, the best tax expert on transfer prices of luxury goods in the world works for LVMH. The currency hedging strategies at the group level is extremely important for our companies' currency risks. Without them, we would have been deeply affected by the latest fluctuations in the currency markets. Our branch organization alone would never afford the support we have at LVMH.[34]

For smaller brands, access to capital was probably the most important support they received from corporate headquarters. Being part of LVMH allowed them to obtain financial resources that would otherwise be impossible or extremely costly. If these smaller companies tried to finance their growth with debt, financial institutions would demand exorbitant yields, given their size and risk profiles. LVMH diversified risk by investing in different sectors and brands with relevant information and extensive experience to evaluate projects, and could back its debt with a market capitalization of over €20 billion. Hence, LVMH was far more efficient in raising and

[31] Chris Hollis, LVMH's Investor Relations Director, author's interview, October 9, 2003.
[32] LVMH conference call, first half results, September 12, 2003.
[33] Antoine Colonna, "Don't give up on LVMH yet!" Merrill Lynch, October 9, 2003.
[34] Author's interviews with LVMH executives.

assigning capital, and acted as an accelerator of high potential brands. On average, these smaller, riskier companies had access to a weighted average cost of capital of around 7 percent.[35]

A Learning Organization

With more than 50 brands around the world, LVMH had accumulated a huge number of experiences: success and failure stories were told in more than 30 languages. This corporate knowledge represented a key competitive advantage for the conglomerate. The understanding of the luxury market and its customers was an extremely valuable asset for LVMH. One senior executive characterize LVMHS as a "luxury goods university" that attracted an extremely talented pool of managers. LVMH organized seminars in collaboration with prestigious business schools to enhance the exchange and institutionalize that knowledge. All senior executives in charge of various brands could know what was happening in different markets and sectors of the industry. They had access to a rich and extremely useful array of experiences. Even if LVMH favored independence in the management on the brands, executives could confront their views and plans with the other heads of affiliates, giving them a competitive advantage.[36]

Informal Networks and Information Exchange. In 1999, LVMH House was created as a center for corporate development and innovation. It became a space for the exchange and discussion of best practices around the world. In 2000, for example, 400 managers attended the LVMH House in London. In addition, LVMH and the London Business School organized seminars throughout the year for senior management. These initiatives resulted in cross-fertilization of best practices and the consolidation of a worldwide network. That same year, the conglomerate established 'transversal projects' that would include managers of different affiliates to address a project or initiative that could yield results for the group.

Putting numerous affiliates under the same roof was also a catalyst for information sharing. Corporate headquarters in Japan, France and the U.S. fulfilled that mission. The Portzamparc building in New York, inaugurated on December 8 1999 in the heart of Manhattan, was a great example. The 23-story building, designed by architect Christian de Portzamparc, had a Christian Dior boutique on the first floor, while corporate services, Louis Vuitton, Parfums Christian Dior, Guerlain, Celine, and Loewe shared the rest of the building.

The resulting informal networks were essential to the collaboration between affiliates and branches across all levels of the organization. They were the origin of collaboration in marketing initiatives and business development opportunities.

Corporate Entrepreneurs. As with its brands, LVMH believed in investing with patience in future leaders. Every year, the company hired high potential managers and prepared them to manage business units within a few years. In 1999, it established the Futura program to hire MBA students around the world. This talent was nurtured with operational exposure in many sectors and countries. Human resources committees at the branch and corporate levels were held to assign the human capital to the affiliates. In 2000, the internal mobility of managers fulfilled 36 percent of all job openings, and 65 percent of senior managers' positions.[37] One LVMH

[35] Antoine Colonna, op.cit.
[36] Author's interview, July 2003.

human resources manager explained the importance of the managers' understanding of cultural diversity within the company:

> We expect a lot from the managers and executives of LVMH. It is paramount that they understand the particularities of each culture and adhere to the overarching values of the group. We create the appropriate environment for entrepreneurs to generate a positive dynamic where managers can take advantage of opportunities that benefit their brands. There are no barriers or rigid policies. The system in place allows for initiatives that create value for a brand, such as a synergy, to be implemented. The organizational design is not as critical as the right environment. The latter is key to allow our talented and motivated pool of entrepreneurs to flourish and make their brands more successful.[38]

CONCLUSION

LVMH was accustomed to dealing with the vicissitudes of fashion, however, as a global company, it also faced challenges from the changing tastes of currency markets. For example, into 2004, the U.S. dollar hit record lows against the euro. This currency fluctuation adversely affected LVMH's financial results, with sales in dollars worth fewer and fewer euros. This development represented the new reality of LVMH's global luxury business. The environment would be challenging for LVMH even if some of the respective economies in which it operated improved. An ever-growing LVMH had to be prepared to adjust to a wider variety of shocks—from fashion trends to currency exchange rates. The company's corporate structure had to be flexible and efficient; maximizing the value of the strategic integration without undermining the speed and adaptability of its affiliates. Any organizational design and resource allocation policy would have to balance the strength of a large company and the flexibility and focus of a small business.

Some executives at LVMH worried that the company would not be able to maintain this balance as it grew. The organizational design had created an additional layer in the reporting structure, had decreased the visibility of Bernard Arnault on his 'star brands' and had added bureaucracy at the country level. It had been successful at reducing the back office costs and had benefited the smaller companies of the group; but the added complexity had undermined the flexibility and dynamics of other brands. Patrick Houel was in a particularly good position to evaluate the issue. He favored a pragmatic approach that could extract as much value as possible by determining the extent of the strategic integration with the nature and external context of each of the activities of the group. The organizational design and the implementation of this approach would be critical to the success of LVMH going forward. If it achieved its ambition of doubling sales in the next five years, it would need an organizational structure that was able to maintain the energy and identity of the brands while extracting as much value as possible from the strategic integration of its affiliates.

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[37] LVMH Annual Report, 2000.
[38] Author's interview, September 2003.

Appendix 1
The Luxury-Goods Industry

Evolution of the Industry

The Elitist Industry (19th to mid-20th century). The modern luxury-goods industry has its origins in 19th century in Europe. Born with the industrial revolution, when entrepreneurs such as Thierry Hermès, Louis Francois Cartier and Louis Vuitton established their companies to satisfy the desires of the new industrial fortune-makers. They created exceptional products that represented the elitist lifestyle of the time: horse riding, travel in boats, and society parties. At the time the potential growth was limited to the richest customers. They had to establish themselves outside their country of origin to reach a large customer base. Since the beginning, the luxury-goods companies were international and it was very common to open store branches all over Europe and in the U.S. Generation after generation the *savoir faire* was transmitted and the tradition was maintained. As decades went by, each generation enriched its family businesses with innovations and newfound ambition. As business grew, the reputation for exceptional quality evolved in well-established brands. The customer base became broader as the elites of the world became larger and more diverse. More and more people had access to a luxury lifestyle or at least a portion of it. After more than a century of prosperity the family business structures became less suited to carry their companies to the next big evolution of luxury - its democratization.

The Democratization of Luxury (1970s and 1980s). In the seventies and eighties, the expansion of product offering, growth of the distribution network, a boom in travel and the introduction of affordable products drove the democratization of luxury. It also happened with the greater exposure of luxury brands. The business models changed from a purely elitist approach with exceptional quality (classic luxury), to the management of a delicate balance between wide distribution and the essence of luxury (modern luxury). A fine-tuned strategy meant great growth fostered by the increase in volumes and preservation of the exceptional gross margins that characterized the industry. At the time of the democratization of luxury, the South East Asian market for luxury goods exploded. The growth of the economies of the region and the appetite for European brands in the region created incredible impetus for the luxury-goods companies. With the success came great pressure on the family structures that soon were replaced by investors attracted by the exceptional results and potential of the industry. Many luxury-goods companies became public and some saw the founding families leave.

Industry Consolidation and the Luxury Bubble (1990s). The nineties brought even more prosperity and a major change in the industry. The prosperity in the U.S. economy, the exuberance in the financial markets and the consolidation of the South East Asian and Japanese markets boosted cash flows. The need to maintain high returns on investments and the accumulation of cash contributed to the industry's consolidation. According to French newspaper *Les Echos*, between 1998 and 1999, 179 luxury-goods companies changed their major shareholders. The industry was valued at more than $60 billion[39] in 1999 and companies were valued at 30-times earnings.[40] Following the leadership of LVMH, the first and leading luxury-

[39] Eurostat Study/Colbert Committee, 1999.
[40] Luxe Conference: Creation, Mergers and the Internet, Paris, March 2000.

goods conglomerate, the industry began a wave of consolidation with huge premiums. LVMH, Richemont, Swatch Group, Gucci and to some extent Hermès acquired stand-alone brands and small conglomerates in all the sectors of the industry: watches, jewelry, fashion and leather goods, selective retailing, perfumes, cosmetics and in the case of LVMH, wines and spirits. A few conglomerates controlled most of the successful brands in the industry and achieved a position with great access to capital, huge investments in communication and a worldwide distribution network.

The End of Exuberance (2001 to 2003). The exuberance of the 1990s shaped the luxury-goods industry as it entered the new millennium. The impact of 9/11 and the world's economic slowdown represented the first big challenge of the century for the recently expanded multi-brand conglomerates. Productivity, synergies and cost cutting entered the vocabulary of industry leaders. The exorbitant prices of the acquisitions of the 1990s needed to be justified with tangible results. Promised synergies and economies of scale had to be implemented. The times of long queues outside Louis Vuitton stores in Paris was over.

What Makes a Luxury Brand?

Given the diverse sectors that constitute the industry and the ambiguous nature of luxury, there is little consensus about a luxury-goods industry definition. During the highest growth years, this definition was used and abused to justify acquisition or to protect the industry against incumbents. Although it is difficult to define, most of the brands that have been successful at achieving a leading position in the luxury-goods industry share the values of excellence, brand and desirability.

Excellence. The strongest association with luxury in the consumer's mind is with excellent quality.[41] It is the *sine qua non* condition for a luxury product or service. The reliability of an automatic movement of Rolex, the quality of a Fendi fur, the distinctive flavor of a Sauternes wine of Chateau d'Yquem or the durability of a Louis Vuitton suitcase have to be near perfection to command the reputation and justify the premium paid by consumers. The superior technique at the origin of the excellent quality is the result of years of craftsmanship, and continuous improvements. For most companies, it means maintaining the production processes of 19th century or even the 18th.[42]

The obsession with excellence is to be found in every luxury-goods company and in all its dimensions. Getting a superior service is expected when entering a luxury-goods store in every continent. "Entering a luxury-goods store and buying a Vuitton suitcase is an important event for our customers and has to be treated as such. We represent the image of Vuitton for the customer,

[41] Bernard Dubois, Gilles Laurent and Sandor Czellar, "Consumer Rapport to Luxury: Analyzing Complex and Ambivalent Attitudes," HEC School of Management (research paper).

[42] This focus on quality has many implications in the economics of the industry. First production requires the same time and processes as in the past, and in today's economic reality it means bearing high costs of production. Second, it has made the delocalization to cheaper labor countries almost unthinkable.

the image of exceptional quality," says Virginie Liou to 20 sales interns the first day of training in the corporate headquarters of Louis Vuitton.[43]

Brand Aura. By achieving excellence these companies gained through the years a strong reputation and positioned their brands among consumers. The luxurious and social connotations of these brands allow luxury-goods consumers to have a "high society status" or to demonstrate prosperity. This consumer feeling is particularly strong in Japan where the industry finds one of its best markets.

To achieve luxury status, brands need to have a strong aura that has to be legitimate and identifiable. The legitimacy is usually brought by an ancestral heritage and a long tradition of excellence. It can also come from a strong personality, a talented creator that stamps his personality and gives life to the brand. Hence, numerous brands in the industry carry the name of the founder and creative mind behind the company. They are almost legends of their times. Hence it is not easy to create or imitate the legitimacy and the dream of a luxury brand even with great financial resources. "A brand must have a heritage; there are no shortcuts," notes Bernard Arnault.[44]

Desirability. The last common element of an established company in the industry is the capacity to create and maintain desirability. Although the concept is ambiguous, it can be defined by touching on some of the elements that companies need to achieve it. One element is a strong aesthetic appeal, modern but related to traditional values. The designer plays a major role in this respect. Another element is the high price of the items; this makes it more difficult to gain, and thus gives strength to the social symbolism of the product. For example, the highest volume of sales of Hermès' scarves corresponded to the period of highest prices in its history. [45] Lastly, the scarcity and uniqueness of the products are also elements of this relationship between the consumer and the luxury brand. The consumer becomes emotionally involved. The luxury-goods companies have been able to manage a certain level of exclusivity even with high volumes. Limited editions, special orders, numbered series and waiting lists are carefully managed to nurture the desirability of the brand.

[43] Author's LVMH internship training, summer 2003.
[44] Suzy Wetlaufer, "The Paradox of Star Brands," *Harvard Business Review*, October 2001, p. 116.
[45] Sophia Richou, Michel Lombard, "Le Luxe dans tous ses Etats," *Economica* 1999.

Appendix II

Stars and Rising Stars Among the LVMH Brands

Of the many brands owned by LVMH, only a handful has reached the status of a 'star.' In an interview published by the *Harvard Business Review*,[46] Arnault explained the paradox of a 'star' brand: "I would say there are four characteristics required [to become a star brand]. A star brand is timeless, modern, fast-growing and highly profitable."

The strategy that LVMH has pursued is founded on developing its 'star' brands and nurturing 'rising stars'. The former has been an essential driver for the organic growth of the company,[47] the latter represents the future profit drivers of the luxury conglomerate. Moët Chandon, Dom Perignon, Hennessy, Louis Vuitton, Christian Dior,[48] and TAG Heuer have struck the right balance between modernity and heritage, between growth and profitability—both Moët Chandon and Louis Vuitton are among the 100 most valuable brands in the world according to Interbrand. Fendi, Kenzo Parfums and DeBeers are its 'rising stars,' promising future returns and growth relays for LVMH.

Louis Vuitton: The Brightest Star

"The biggest, fastest-growing and most profitable luxury brand in the world," Louis Vuitton has been the engine inside LVMH leadership in the industry. With 22 percent of LVMH sales, it has been by far its largest cash provider in recent years. In 1997, it accounted for more than half of the group's EBIT. In 2001, Vuitton's contribution reached a record 82 percent. Its fully owned distribution network doubled between 1990 and 2002, reaching 300 directly owned stores and global stores around the world. [49] The company was vertically integrated in most of its product offerings, producing the canvas, assembling the bags and selling them to the end consumer. This integration allowed Vuitton to maintain rigorous control of the quality of the product and the services around it. It also enabled the company to attain estimated gross margins of 80 percent.[50]

When Louis Vuitton founded his company in 1854, he produced and distributed the finest and most innovative luggage for the traveling needs of the industrial "bourgeoisie". Soon, stores were opened in Paris and in London. The company quickly earned a reputation and when Gaston Vuitton, son of Louis Vuitton, took over he expanded the collection with the now famous handbags in the printed monogram in 1902. He also grew the number of store locations. Thereafter, the company kept growing with each generation. From 1977 to 1987, Louis Vuitton expanded its chain of shops from two to 88, brought in outside investors, went public and

[46] Bernard Arnault, "The Perfect Paradox of Star Brands," *Harvard Business Review*, October 2001.
[47] In the past decade, LVMH has yielded 15 percent yearly growth in revenue, of which 9 percent has been achieved through organic growth. ("Hardly Growth through Acquisitions!" Lehman Brothers, July 2002.)
[48] Christian Dior Couture and Parfums Christian Dior are two separate entities. LVMH owns Parfums Christian Dior and Christian Dior Watches and its results are fully consolidated. LVMH and Christian Dior Couture are indirect and direct affiliates of the same company: Christian Dior. The latter controls 100 percent of Christian Dior Couture and 100 percent of the controlling company of LVMH. An eventual integration of Christian Dior Couture into LVMH is not in the plans of the Arnault Group.
[49] "LVMH: Full of Potential, Will it be Realized?" Merrill Lynch, November 2002.
[50] Ibid.

exploited the strong appeal of its name by gaining a New York share quote—the first French company to do so. But it was not until LVMH was created that the Louis Vuitton brand reached its full potential as a luxury icon. Micheline, an employee since 1976 and part of the sales team at the Avenue Marceau store at the time, remembers: "Nothing changed, really. They were smart to maintain the culture and the tradition intact, but we were suddenly more dynamic and more focused on the future."

LVMH preserved most of the aspects that made Vuitton successful—its teams, its tradition, its culture, all part of the brand's 'soul'. It added resources and ambition. It kept producing the hundred-years-old monogram but invited talented designers such as Takeshi Murakami, Bob Wilson or Marc Jacobs, current head of design, to revisit and add some sparks to the brand. It maintained religiously its pictures of the founder on the walls of stores and offices, but it used J-Lo (U.S. actress and singer Jennifer Lopez) to represent the brand for the fall and winter 2003 campaign. It kept producing the suitcases with the same processes and materials as did Louis Vuitton in the 19th century, but it extended its product offering to prêt-a-porter, shoes, watches and jewelry. That balance between tradition and modernity, together with the financial resources used to grow and enhance its distribution network and to support the brand with a generous advertising budget, are essential elements brought by LVMH and Yves Carcelles, chairman of Louis Vuitton since 1989.

Throughout most of its history, Vuitton focused on luggage and leather goods. It extended its product offerings prudently to take advantage of its customer base and the strength the Vuitton brand. The first major product extension outside of the travel and bag collection was the introduction of the shoe collection in 1998. StefanoBi, Berluti's affiliate based in Ferrara, Italy, participated in the production of Louis Vuitton's shoe line. In 1998, Louis Vuitton also launched a complete ready-to-wear collection designed by the American, Marc Jacobs. It profited from the rich experience of the group in the fashion industry—brands such as Givenchy, Christian Dior Couture and Celine. The relationship with the fashion houses shortened the learning curve and implementation time. Although, it seldom surpassed a small percentage of store sales, Vuitton invested significant store space, specially trained sales teams, as well as part of its advertising budget. The Jewelry and Watch collection was the most recent product extension. In 2002, the first watch carrying the Vuitton colors reached the Vuitton global stores. It was not a coincidence that the automatic movement inside the new Tambour watch was manufactured by Zenith, producer of award winning watch movements and part of LVMH since 1999. The limited edition was completely sold out shortly afterwards, and the high-priced permanent collection had a worldwide waiting list of 6,000[51] in May 2003.

DeBeers: Rising Star

The world's largest producer and trader of diamonds, DeBeers had wanted for a long time to take full advantage of the brand it had invested in. The now famous diamond campaigns were intended to boost consumption of unbranded diamonds. Given its market share,[52] the South African company immediately captured most of the value created from an increase in world

[51] LVMH, May 2003.

[52] 40 percent of global production by value and 60 percent of global trade of diamonds according to Merrill Lynch. Source: "Diamonds to be LVMH's best friend?" Merrill Lynch, January 2001.

demand for diamonds. The byproduct of these marketing efforts, close to $200 million invested every year, was the brand recognition of DeBeers.

LVMH was clearly a likely choice for a partner. Not only because LVMH had demonstrated its skills at developing luxury brands around the world, but also because other alternatives such as Richemont, owner of Cartier, and Bulgari might have conflicts of interest with managing another jewelry brand. DeBeers could sell the brand, enter a royalty agreement or create a joint venture with LVMH. It selected the third option. The joint venture would create a retail branded product which would be operated by LVMH: the rights for the brand DeBeers would be owned by the JV and each party would invest $200 million for the first five years of development. The future earnings of DeBeers LV would be shared between LVMH and the South African mining giant 50/50 for the first $50 million, 40/60 respectively between $50 and $300 million and back to 50/50 above 300 million.[53] Pierre Mallevays, who participated in the negotiation process, commented on the reasons for the alliance:

> The joint venture with DeBeers is a good example of creating something new but with an established brand. DeBeers has always invested heavily in advertising diamonds to promote sales of diamonds but without ever selling a branded product. "A diamond is forever" by DeBeers is known across the world, even its jingle is recognized, but that incredible asset was not exploited. The joint venture with LVMH will capitalize on DeBeers brand and LVMH's know-how.

In November 2002, DeBeers LV opened its first jewelry store in the corner of Piccadilly and Old Bond Street in London and with plans to open new stores in Japan in 2003.

No Star for Christian Lacroix

After more than a decade of investment in the brand named after the French designer Christian Lacroix, it has yet to become profitable. It is true that the adventure of creating a brand is not something that the group endeavors to do frequently. In fact, Christian Lacroix is the only brand in the conglomerate portfolio that was started from scratch. It is also the clearest example that the art of developing international luxury brands is indeed different from the art of creating one. Arnault described the progress of this instructive yet unsuccessful investment.[54]

> It has been like a laboratory for us where we have learned how to start a brand from scratch. I mean, at the beginning, we thought, 'Okay, we have a genius here with Christian Lacroix,' but we learned that genius is not enough to succeed. It was something of a shock, to be honest, to discover that even great talent could not launch a brand from zero. A brand must have a heritage, there are no shortcuts.
>
> The fact is star brands take time to grow. Take some of the small make-up companies we have acquired recently, like Bliss and Urban Decay. When we bought them, they were little start-ups run by their founders—very simple

[53] Stephane Marchand, "Les Guerres du Luxe," Fayard, 2002.
[54] Bernard Arnault, "The Perfect Paradox of Star Brands," *Harvard Business Review*, October 2001.

businesses, but with a lot of originality in the products. So now we know we have to nurture them until they have some history. But even if it takes 10 to 15 years for them to become a star, that has been an amazing investment, right?

Exhibit 1
Selected Financial Information for LVMH

Financial Results Fiscal Years 2002-2003

In millions of Euros	2002	2003	% change
Net sales	12,693	11,962	- 6%
Operating income	2,008	2,182	+ 9%
Net income before goodwill amortization	818	1 023	+ 25%
Net income	556	723	+ 30%

NB: The company states that with organic growth, e.g., with comparable structure and exchange rates, for 2003 was +4%.

Financial Results by Group 2002-2003

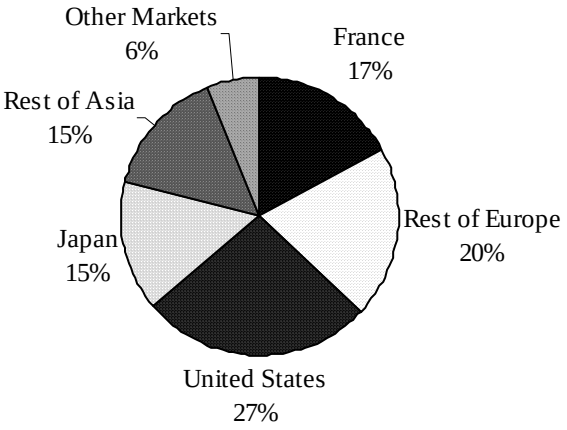
In millions of Euros	2002	2003	% change
Wines & Spirits	750	796	6%
Fashion & Leather Goods	1,280	1,311	2%
Perfumes & Cosmetics	161	178	11%
Watches & Jewelry	(13)	(48)	-269%
Selective Retailing	20	106	430%
Other businesses and eliminations	(190)	(161)	-15%
Total LVMH	2,008	2,182	9%

Source: For all of Exhibit 1, the source is LVMH 2003 annual report.

Exhibit 1 (continued)
Selected Financial Information for LVMH

Net Sales by Geographic Region

2002



2003

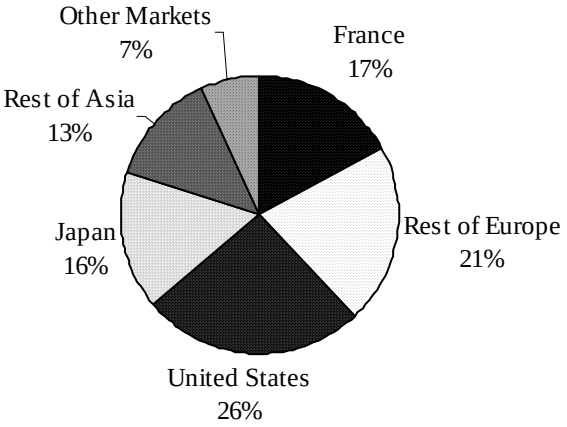


Exhibit 1 (continued)
LVMH
Consolidated Statement of Income

(EUR millions except earnings per share, stated in Euro)	**2003**	**2002**	**2001**
Net Sales	11,962	12,693	12,229
Cost of sales	(4,171)	(4,563)	(4,654)
Gross Margin	7,791	8,130	7,575
Marketing and selling expenses	(4,401)	(4,705)	(4,568)
General and administrative expenses	(1,208	(1,417)	(1,447)
Income from operations	2,182	2,008	1,580
Financial expense-net	(233)	(294)	(459)
Dividends from unconsolidated investments	18	8	21
Other income or expenses – net	(349)	(405)	(455)
Income before income taxes	1,618	1,317	667
Income taxes	(488)	(350)	(192)
Income (loss from investments accounted for using the equity method	1	(18)	(42)
Net income before amortization of goodwill, minority interests and unusal items	1,131	949	433
Amortization of good will	(300)	(262)	(168)
Minority interest	108)	(131)	(99)
Unusual items – net	---	---	(156)
Net Income	723	556	10
Net Income Before Minority Interests	831	687	100
Net income before amortization of goodwill and unusual items	1,023	818	334
Earnings per share before and after dilution			
Earnings per share before amortization of goodwill and usual items	2.09	1.67	0.68
Earnings per share	1.48	1.14	0.02
Number of common shares and share equivalents	489,844,910	488,852,554	488,072,374

Exhibit 1 (continued)
LVMH
Consolidated Balance Sheet at December 31

Assets *(EUR millions)*	2003	2002	2001
CURRENT ASSETS			
Cash and cash equivalents	823	812	795
Short-term investments	231	60	622
Treasury shares	427	544	1,046
Trade accounts receivable	1,375	1,327	1,538
Deferred income taxes – net	451	555	544
Inventories and work-in-progress	3,415	3,427	3,655
Prepared expenses and other current assets	1,202	1,202	1,352
TOTAL	7,924	7,927	9,552
INVESTMENTS AND OTHER ASSETS			
Investments accounted for using the equity method	49	68	77
Unconsolidated Investments and other investments	848	869	1,386
Treasury shares	404	362	318
Other non-current assets	338	511	467
Goodwill and similar intangible assets – net	3,410	3,631	3,516
Brands and other intangible assets - net	3,902	4,199	4,308
Property, plant and equipment – net	3,668	3,850	4,208
	12,619	13,490	14,280
TOTAL	20,543	21,417	23,832
Liabilities and stockholders' equity			
CURRENT LIABILITIES			
Short-term borrowings	1,245	2,304	3,765
Accounts payable	1,639	1,429	1,401
Accrued expenses and other current liabilities	2,302	2,533	2,622
Income taxes	61	61	--
Current portion of long-term debt	871	274	238
TOTAL	6,118	6,601	8,026
DEFERRED INCOME TAXES – NET	158	125	169
LONG-TERM LIABILITIES			
Long-term debt, less current portion	4,297	4,554	5,402
Other log-term liabilities	1,133	1,073	1,250
Repackaged notes	158	222	284
TOTAL	5,498	5,849	6,936
MINORITY INTERESTS IN SUBSIDIARIES	1,735	1,772	1,800
STOCKHOLDERS' EQUITY			
Common stock	147	147	147
Additional paid-in capital	1,736	1,736	1,736
Cumulative translation adjustment	(623)	(222)	(140)
Retained earnings	5,774	5,409)	5,158
TOTAL	7,034	7,070	6,901
TOTAL	20,543	21,417	23,832

Exhibit 1 (continued)
LVMH
Consolidated Statement of Cash Flows

(EUR millions)	2003	2002	2001
1. OPERATING ACTIVITIES			
Net income	723	556	10
Minority interests	108	131	90
Equity interest in undistributed earnings of associated companies, net of dividends received	5	17	46
Depreciation and amortization	914	1,019	1,356
Change in provisions	11	(386)	658
Change in deferred taxes	130	(142)	(304)
Gain (loss) on disposal of fixed assets or treasury shares	58	323	(937)
Net cash provided by operating activities before changes in current assets and liabilities	1,949	1,518	919
Inventories and work-in-progress	(222)	33	(358)
Trade accounts receivable	(1)	64	128
Accounts payable	88	82	(25)
Other current assets and liabilities	28	257	(90)
Net change in current assets and liabilities	(107)	436	(345)
Net cash provided by operating activities	1,842	1,954	574
II. INVESTING ACTIVITIES			
Purchase of brands and other intangible assets	(70)	(80)	(80)
Purchase of property, plant and equipment	(508)	(479)	(904)
Sale of non-financial fixed assets	82	177	149
Acquisitions of investments	(78)	(92)	(445)
Reclassification between investments and short-term investments	–	–	(677)
Proceeds from sale of unconsolidated investments	13	92	2,122
Change in other non-current assets	19	(182)	(431)
Net effect of acquisitions and disposals of consolidated companies	(209)	(260)	(628)
Net cash provided by (used in) investing activities	(751)	(724)	(894)
III. FINANCING ACTIVITIES			
Shares of minority interest in proceeds from issuances of common stock	70	13	38
Change in treasury shares	196	516	(13)
Dividends and interim dividends paid by the parent company (including related tax)	(374)	(349)	(343)
Dividends and interim dividends paid to minority interest of consolidated subsidiaries	(74)	(23)	(171)
Proceeds from short-term borrowings and long-term debt	1,452	523	2,469
Principal repayments on short-term borrowings and long-term debt	(2,114)	(2,408)	(2,294)
Change in listed securities	(170)	182	880
Net cash provided by (used in) financing activities	1,014)	(1,546)	566
IV. EFFECT OF EXCHANGE RATE FLUCTUATIONS	(18)	(18)	2
Net increase/decrease in cash and cash equivalents	59	(334)	248
Cash and cash equivalents at beginning of year (net of bank overdraft)	544	878	630
Cash and cash equivalents at year-end (net of bank overdraft)	603	544	878
Non-cash transactions:			
- Lease financing operations	2	3	16

Exhibit 2
The Houses of LVMH

Wines and Spirits

	Origin	*Founded*
Moët Chandon	France	1743
Dom Perignon	France	
Mercier	France	1858
Ruinart	France	1729
Veuve Cliquot	France	1772
Canard-Duchene	France	1868
Krug	France	1843
Chandon Estates	US, Australia	1997
Cloudy Bay	New Zeland	1985
Cap Mentelle	Australia	1976
Newton	California	1978
Mount Adam	Australia	1972
Chateau d'Yquem	France	1593
Hennessy	France	1765
Hine	France	1763

Fashion and Leather Goods

Louis Vuitton	France	1854
Loewe	Spain	1846
Celine	France	1945
Berluti	Italy	1895
StefanoBi	Italy	
Kenzo	France	1970
Givenchy	France	1952
Christian Lacroix	France	1987
Marc Jacobs	US	1984
Thomas Pink	England	1984
Emilio Pucci	Italy	1948
Donna Karan	US	1984
Fendi	Italy	1925

Perfumes and Cosmetics

	Origin	*Founded*
Parfums Christian Dior	France	1947
Parfums Givenchy	France	1957
Guerlain	France	1828
Parfums Kenzo	France	1987
Acqua Di Parma	Italy	1916
Make Up Forever	France	1989
Fresh	US	1991
BeneFit	US	1995
Bliss	US	1996

Watches and Jewelry

Tag Heuer	Switzerland	1860
Montres Christian Dior	France	
Zenith	Switzerland	1865
Ebel	Switzerland	1911
Chaumet	France	1780
Fred Paris	France	1936
Omas	France	1925
DeBeers LV	France, UK	2001

Selective Retailing

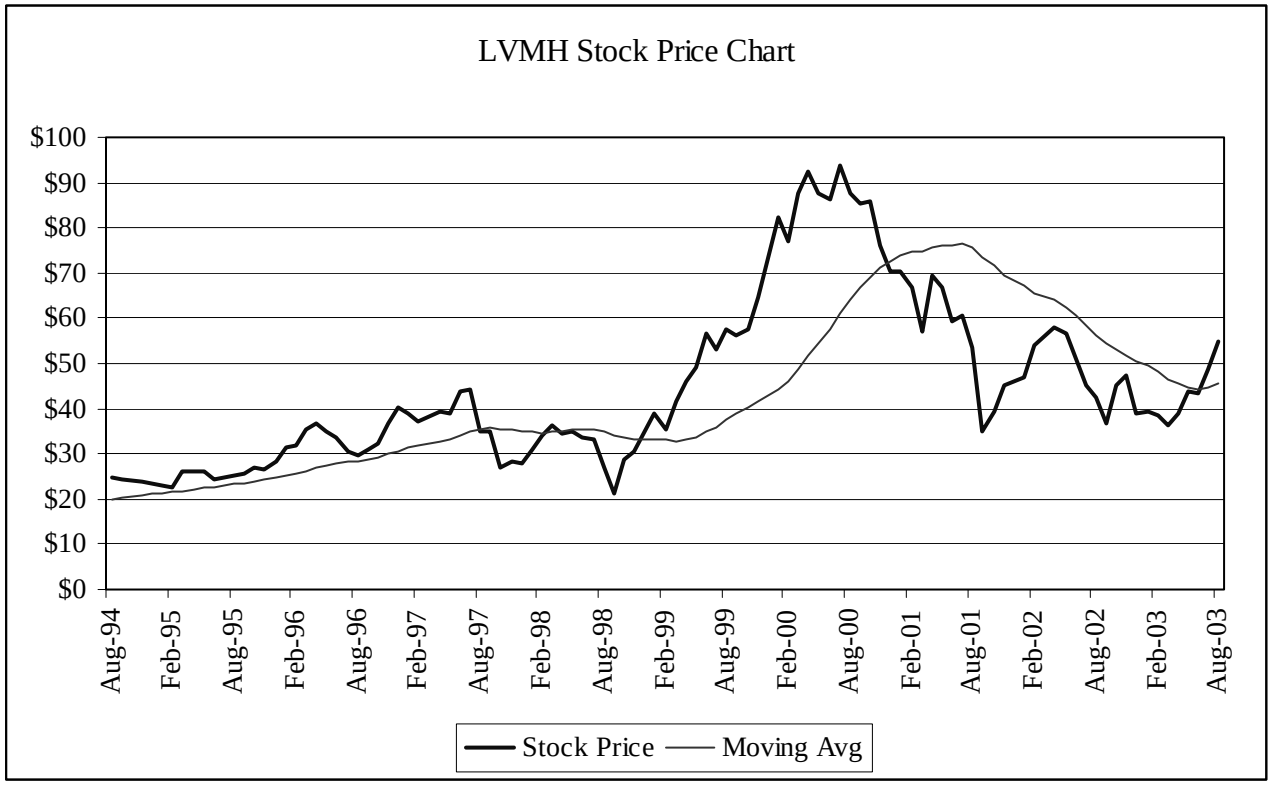
Sephora	France	1973
Duty Free Shopper (DFS)	US	1960
Miami Cruiseline	US	1963
Le Bon Marche	Paris	1852
La Samaritaine	Paris	1870

Other Activities

e-Luxury	France
L Capital	France
DI Group	France

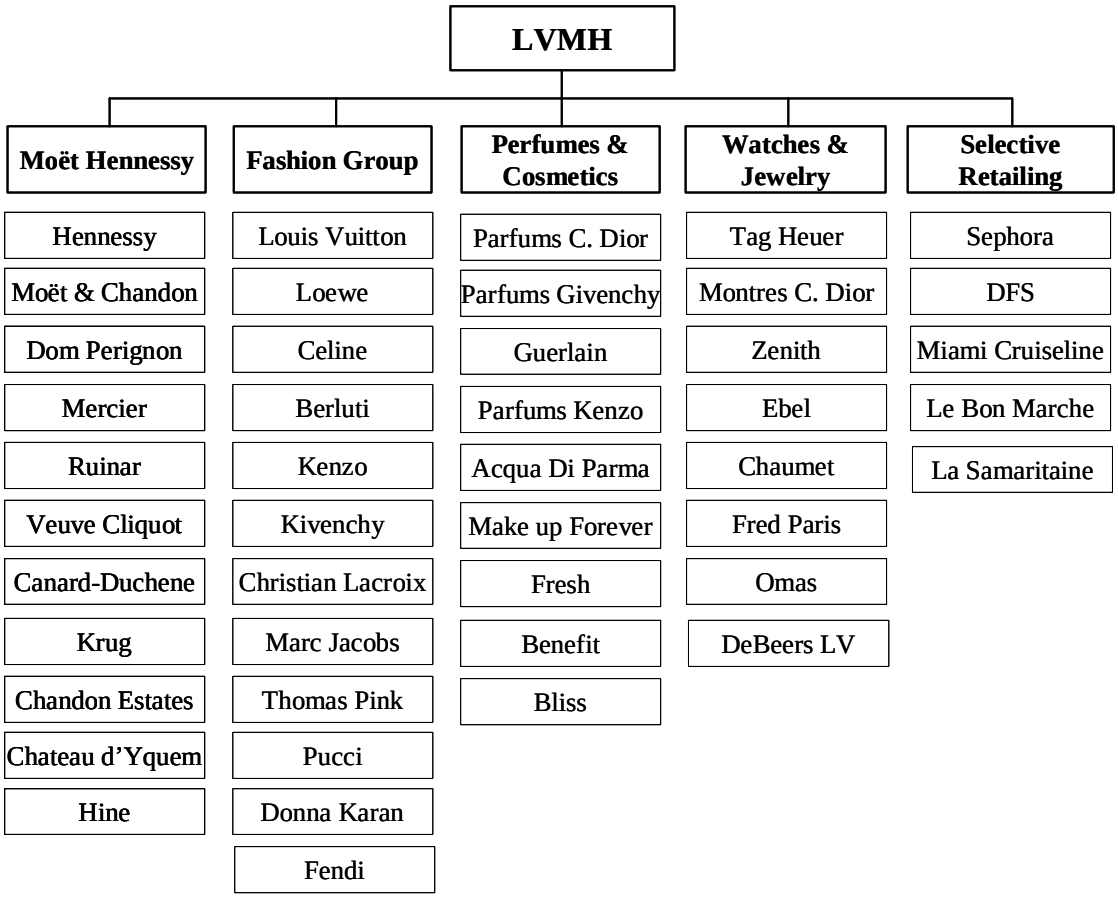
Source: LVMH, Annual Report 2002

Exhibit 3
LVMH Stock Price Performance (1994-2003)



Source: Thomson One Banker Analytics

Exhibit 4
Organizational Chart 2002
Simplified chart not including other activities



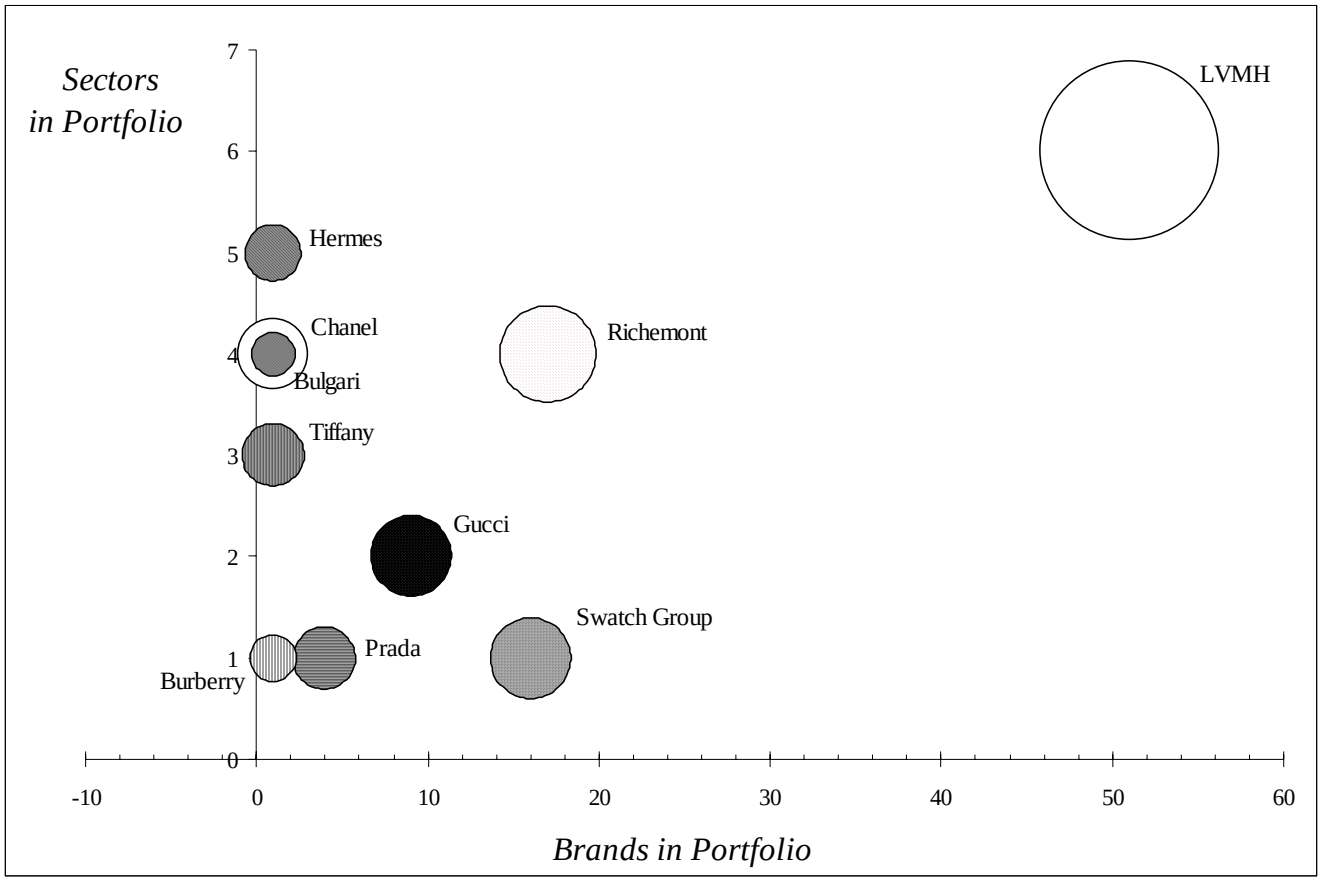
Source: Author and company reports

Exhibit 5A
Luxury Goods Brand War – Top Ten Players

	Sectors	***Brands in Portfolio***		
LVMH				
Richemont	*Watches* *Jewelry* *Fashion* *Leather Goods*	Cartier Van Cleef & Arpels Vacheron Jaeger-LeCoutre IWC Alfred Dunhill	Constantin Mont Blanc Montegrapa Old England Shangai Tang Lancel	Piaget Baume et Mercier A. Lange & Sohne Officine Panerai Chloé
Swatch Group	*Watches* *Jewelry*	Breguet Blancpain Glasshutte Original Jaquet-Droz Omega Swatch	Ck Watches Certina Mido Halmilton Pierre Balmain Endura	Longines Rado Tissot Flik Flak
Gucci Group	*Fashion* *Leather Goods* *Perfume/Cosmetics*	Gucci Yves Saint Laurent Alexander McQueen Stella McCartney Sergio Rossi	Bottega Veneta Boucheron Roger & Gallet Bedat & Co	
Chanel	*Fashion* *Leather Goods* *Jewelry* *Perfume/Cosmetics*	Chanel		
Tiffany	*Jewelry* *Watches* *Home*	Tiffany		
Prada Group	*Fashion*	Prada Jil Sander Helmut Lang Churcu		
Hermès	*Fashion* *Leather Goods* *Perfume/Cosmetics* *Jewelry* *Home*	Hermès John Lobb Gautier (35%) Leica Camera (31.5%)		
Burberry	*Fashion*	Burberry		
Bulgari	*Jewelry* *Watches* *Accessories*	Bulgari		

Source: Company reports.

Exhibit 5B
Luxury Goods Brand War – Industry Map in 2002*



* The areas of the circles are sized according to the 2002 revenues for each company. Sectors include fashion & leather goods, watches, jewelry, perfume & cosmetics, wines & spirits and selective retailing. Companies may be involved in a sector with several brands (for example, LVMH in the fashion & leather goods sector or Richemont in the Watches sector) and/or may use a single brand to serve several sectors of the industry (Hermès and Chanel). No negative values can be attributed to brands in portfolio.

Source: Author, Company reports

Exhibit 5C
Selected Financial Data for LVMH Competitors in Fiscal Year 2003
(in millions of euros)

	Bulgari	*Gucci Group*	*Hermès*	*Financière Richemont*
INCOME STATEMENT				
Total Revenue (Net Sales)	726	2,544	1,242	3,651
Cost of goods sold	248	802	(437)	(1,367)
Gross Margin	**478**	**1,742**	**805**	**2,284**
	66%	*68%*	*65%*	*63%*
Selling and Administrative expenses	371	1,436	(436)	(2,025)
Operating Income	107	179	320	259
Amortization and Depreciation	(40)	(243)	(43)	(446)
Financial Income (Expense)	(9)	1	8	(56)
Pretax Income	90	241	328	475
Net Income	**76**	**227**	**220**	**728 ***
BALANCE SHEET				
Assets				
Cash & Short-term Investments	49	2,935	520	150
Receivables	225	332	228	950
Inventories	477	472	274	1,604
Total Current Assets	**754**	**4,366**	**1,022**	**2,704**
Net Property, Plant and Equipment	88	912	419	735
Other Assets	81	135	77	1,775
Goodwill	8	2,110	45	2,009
Total Assets	**931**	**7,781**	**1,562**	**7,223**
Liabilities and Stockholders' Equity				
Current Liabilities	281	1,380	383	1,421
Long-term Debt	70	1,202	64	410
Other Liabilities	32	462	74	195
Stockholders' Equity	548	4,671	1,042	4,998
CASH FLOW				
Net Cash (used in) provided by Operations	180	247	247	652
Net Cash (used in) provided by Investments	(35)	(362)	(99)	(269)
Net Cash (used in) provided by Financing	(60)	217	(61)	(498)

* includes exceptional gain on British American Tobacco equity valuation of 300 million euros

Source: Company reports