



LVMH's Diversification Strategy into Luxury Goods

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In 2002, Moët Hennessy Louis Vuitton (LVMH) was the world's largest luxury products company, with annual sales of 12.2 billion euros (€) and a business portfolio that included some of the most prestigious brand names in wines and champagnes, fashion, watches and jewelry, and perfumes and cosmetics. The French conglomerate's business portfolio also included two prestigious Parisian department stores, two chains of duty-free shops, a retail cosmetics chain, e-commerce businesses, and a variety of French media properties. Even though no one "needed" LVMH's products—a magnum of its 1985 Dom Pérignon Rose champagne retailed for \$925, its Givenchy gowns could exceed \$15,000, and the finest TAG Heuer watch carried a retail price of about \$58,000—the company's products were desired by millions across the world. CEO Bernard Arnault suggested that desire for the company's products "in some way, fulfills a fantasy. You feel as if you must buy it, in fact, or else you won't be in the moment. You will be left behind."¹

The company's business portfolio began to take shape in 1987 when Louis Vuitton, known worldwide for its purses and luggage, merged with the maker of Moët & Chandon champagne and Hennessy cognac. LVMH's present lineup of star luxury brands was forged by Bernard Arnault, who became

CEO of the company in 1989 and promptly set about acquiring such names as Christian Dior, Fendi, Donna Karan, Givenchy, Celine, Christian Lacroix, and Marc Jacobs in fashion and leather goods; TAG Heuer and Ebel in watches; and Le Bon Marché and Sephora in retailing. By 2002 Arnault had assembled a portfolio of nearly 50 luxury brands, which he categorized as a collection of star brands and rising stars—brands that Arnault believed "speak to the ages" but, at the same time, feel intensely modern.² Arnault suggested that star brands were not only timeless and modern but also highly profitable and rapidly growing. He portrayed star brands as illogical since, in most cases, the quality of timelessness was in conflict with innovation, and rapid growth usually was at odds with high profits. When asked about the managerial challenges of developing star brands, Arnault stated, "Mastering the paradox of star brands is very difficult and rare—fortunately. In my opinion, there are fewer than ten star brands in the luxury world."³

Arnault believed LVMH's collection of star brands such as Moët & Chandon, Krug, Louis Vuitton, Givenchy, and Parfums Christian Dior and its rising stars like Donna Karan, Christian Lacroix, and Kenzo would lead to long-term corporate advantage since star brands had staying power. "The brand is built, if you wish, for eternity. It has been around for a long time; it has become an institution. Dom Pérignon is a perfect example. I can guarantee that people will be drinking it in the next century. It was

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¹Quoted in "The Perfect Paradox of Star Brands: An Interview with Bernard Arnault of LVMH," *Harvard Business Review*, 79, no. 9 (October 2001), p. 116.

²Ibid.

³Ibid.

created 250 years ago, but it will be relevant and desired for another century and beyond that.”⁴

Arnault’s rapidly growing portfolio had allowed LVMH to grow from approximately €2.5 billion in 1990 to €12.2 billion in 2001. However, the company’s sales growth slowed in late 2001 and early 2002 as the effects of the September 11, 2001, terrorist attacks on New York City and Washington, D.C., and a lingering global recession contributed to a worldwide decline in the purchase of luxury goods. In addition, LVMH management issued three profit warnings during its fourth quarter 2001 prior to announcing a net income of €10 million for fiscal 2001. As LVMH’s stock price reflected the company’s slowing sales growth and weak profitability, its investors began to call for Arnault to evaluate the company’s portfolio for possible restructuring. A summary of LVMH’s financial performance between 1993 and 2001 is presented in Exhibit 1. A time line of its brands is presented in Exhibit 2.

COMPANY HISTORY

LVMH’s history as an enterprise is traced to 1743 when Moët & Chandon was established in the Champagne Province in northeastern France. Moët & Chandon not only became among France’s premier brands of champagne but was also sought after outside of France, with exports accounting for a large percentage of its sales by the 20th century. The company first diversified in 1968 when it acquired Parfums Christian Dior and a 1971 merger between Moët & Chandon and Champagne Mercier combined France’s two best-selling brands of champagne. The company changed its name to Moët-Hennessy when it again merged in 1971; this time with Jas Hennessy & Company, the world’s second largest producer of cognac.

The company diversified further in 1987 as the French government launched into an era of privatization to promote economic growth and reduce the country’s excessively high unemployment rate. The families who controlled Moët-Hennessy and leather goods designer Louis Vuitton saw a merger between their two companies as their best strategy to prevent the companies from becoming takeover targets of large international corporations making investments

in France. The \$4 billion merger that created LVMH allowed the heirs of the two companies’ founders to retain control of the new entity with a combined ownership of 50 percent of outstanding shares. The new ownership structure also placed Hennessy heir and chairman Alain Chevalier in the position of chairman of LVMH, while Vuitton family member and company president Henry Racamier became LVMH’s director general.

The new company became France’s 40th largest company, with total revenues in 1987 of FF 13.1 billion (\$2.1 billion) and a portfolio of such well-known luxury brands as Veuve Clicquot, Moët & Chandon, and Dom Pérignon champagnes; Canard-Duchêne wines; Hennessy cognac; Christian Dior and Givenchy perfumes and cosmetics; Georges Delbard (France’s leading grower of roses); and Louis Vuitton leather handbags and luggage. On the day the merger was consummated, LVMH chairman Alain Chevalier also signed an international distribution agreement with British brewer Guinness PLC to improve the distribution of the company’s champagne and cognac brands in Asia and the United States. The joint venture with Guinness called for both firms to acquire interlocking interests of about 10 percent of each company’s shares and accounted for nearly one-fourth of LVMH and Guinness profits within the joint venture’s first year.

The success of the LVMH-Guinness joint venture led Alain Chevalier to propose that Guinness purchase an additional 10 percent interest in LVMH to further protect the company from possible foreign raiders. The growing relative importance of the company’s wine, champagne, and spirits businesses and the proposal for increased ownership of LVMH shares by Guinness became worrisome to Racamier and other Vuitton family members who believed the company’s core business should center on fashion and leather goods. To fortify the company’s focus on haute couture, Racamier in mid-1988 asked Bernard Arnault (the owner of the Christian Dior, Celine, and Christian Lacroix brands) to purchase shares of LVMH and join forces with Vuitton heirs in their disagreement with Chevalier.

Thirty-nine-year-old Bernard Arnault had only recently become known among France’s business elite, since only four years before he was building condominiums in Florida for his family’s modest real estate and construction firm. Arnault returned to France in 1984 and purchased nearly bankrupt

⁴Ibid.

exhibit 1 **Summary of LVMH's Financial Performance, 1993–2001 (in millions of euros, except per share amounts)**

	2001	2000	1999	1998*	1997*	1996*	1995*	1994*	1993*
Net sales	€12,229	€11,581	€8,547	€6,936	€7,322	€4,748	€4,539	€4,264	€3,630
Income from operations	1,560	1,959	1,547	1,184	1,269	1,071	1,111	1,037	856
Operating margin	12.8%	16.9%	18.1%	17.1%	17.3%	22.6%	24.5%	24.3%	23.6%
Net income before amortization of goodwill and unusual items	€ 334	€ 846	€ 738	€ 525	€ 742	€ 679	€ 640	€ 559	€ 453
Net income	€ 10	€ 722	€ 693	€ 267	€ 690	€ 563	€ 617	€ 979	€ 545
Earnings per share before amortization of goodwill and unusual items	€ 0.68	€ 1.75	€ 1.53	€ 1.07	€ 1.52	€ 1.39	€ 1.31	€ 1.16	€ 0.99
Net income per share	€ 0.02	€ 1.49	€ 1.44	€ 0.55	€ 1.41	€ 1.16	€ 1.26	€ 2.03	€ 1.18
Dividend per share including tax credit	€ 1.13	€ 1.13	€ 1.02	€0.927	€0.927	€0.828	€0.782	€0.711	€0.542
Cash flow from operations	€ 919	€ 1,214	€1,051	€ 571	€1,163	€ 851	€ 904	€ 935	€ 700
Capital expenditures	984	857	574	381	310	n.a.	n.a.		
Stockholders' equity	8,701	8,512	7,781	6,316	6,179	5,486	4,725	4,625	3,567
Long-term debt	5,402	3,498	3,085	1,425	1,382	675	573	794	1,180

n.a. = Not available.

*French franc to euro conversion rate at 6.5595.

Source: LVMH annual reports.

exhibit 2 **History of LVMH Brands**

16th Century		1957	Parfums Givenchy perfumes
1593	Château d'Yquem champagne	1960	DFS duty free shoppers
18th Century		1963	Miami Cruiseline Services duty free shoppers
1729	Ruinart champagne	1970	Etude Tajan fine art auction house
1743	Moët & Chandon champagne	1970	Kenzo fashion
1763	Hine cognac	1972	Mount Adam wine
1765	Hennessy cognac	1973	Domaine Chandon champagne
1772	Veuve Clicquot champagne	1973	Sephora cosmetics retailing
1780	Chaumet watches and jewelry	1974	Investir magazine
19th Century		1976	Cape Mentelle wine
1828	Guerlain perfumes	1979	Art & Auction magazine
1843	Krug champagne	1983	Radio Classique radio network
1846	Loewe leather goods	1984	Donna Karan fashion
1852	Le Bon Marché department store	1984	Marc Jacobs fashion
1854	Louis Vuitton leather goods	1984	Newton wine
1858	Mercier champagne	1984	Thomas Pink fashion
1860	Heuer watches	1985	Benedom-CD Montres watches
1865	Zenith watches	1985	Cloudy Bay wine
1868	Canard Duchêne champagne	1985	La Tribune de l'Economie magazine
1870	La Cote Desfossés publications	1987	Christian Lacroix fashion
1870	La Samaritaine department store	1987	Kenzo Parfums perfumes
1895	Berluti leather goods	1987	Laflachère toiletries/household items
20th Century		1989	Make Up For Ever cosmetics
1911	Ebel watches	1991	Fresh cosmetics
1925	Fendi fashion and furs	1991	StefanoBi leather goods
1925	Omas writing instruments	1995	Hard Candy cosmetics
1930	Acqua di Parma perfumes	1995	BeneFit Cosmetics
1936	Dom Pérignon champagne	1996	Bliss cosmetics and spas
1936	Fred fashion	1996	Urban Decay cosmetics
1945	Celine fashion	1997	Chandon Estates wine
1947	Parfums Christian Dior perfumes	2000	eLuxury Internet luxury retailer
1948	Emilio Pucci fashion	21st Century	
1952	Connaissance des Arts magazine	2001	LVMH/De Beers joint venture diamond retail stores
1952	Givenchy fashion		

Source: LVMH Web site.

Agache-Willot-Boussac—a state-owned conglomerate of retailing, fashion, and manufacturing. The French government sold Arnault the business at far below book value in expectation that privatization would bring an entrepreneurial spirit to the company's collection of businesses and ultimately expand employment by Agache-Willot-Boussac. Arnault saw his mission differently than the French government and sold the assets of Agache-Willot-

Boussac's poor-performing businesses and retained its profitable businesses, of which Christian Dior was the most notable. Within three years of the company's acquisition by Arnault, Agache-Willot-Boussac (renamed Financiere Agache by Arnault) had earned \$112 million on revenues of \$1.9 billion. In 1987, Arnault leveraged Financiere Agache's cash flow from operations and liquidated assets to expand its presence in the fashion industry with the purchase

of Celine, a fashion and leather goods company, and the launch of a new fashion brand headed by France's hottest young designer, Christian Lacroix.

After meeting with LVMH's director general, Henry Racamier, Arnault also met with the company's chairman, Alain Chevalier, before forming a joint venture with Guinness PLC to purchase 37 percent of LVMH's shares. Guinness was receptive to Arnault's proposal to form the joint venture since it assured the British company's management that its highly profitable distribution agreement with LVMH would remain intact, despite the feud between the Hennessy and Vuitton clans. Financiere Agache held a 60 percent interest in the joint venture, while Guinness held 40 percent. The controlling interest in the Guinness-Agache joint venture made Bernard Arnault the largest shareholder of LVMH by November 1988 and gave him a blocking minority of shares. After becoming LVMH's largest shareholder and asked of his intentions to bring about management changes at the company, Bernard Arnault commented that he approved of Chevalier's strategies, but added: "His problem is that he is not a major shareholder. In the businesses I manage, I'm the principal shareholder; and that helps me control the situation."⁵

Bernard Arnault became LVMH's president in January 1989 and chairman in mid-1990 after prevailing in an 18-month legal battle with Henry Racamier, who had petitioned the court to invalidate a portion of Arnault's stake in LVMH. Upon becoming chairman, Arnault launched an aggressive plan to transform LVMH into France's largest company. Arnault dismissed LVMH's top management, folded

Agache's brands and assets into LVMH, and began making rapid acquisitions to expand the company's portfolio of luxury brands. Many French executives resented Arnault's business tactics and questioned his motives in becoming the head of LVMH. An ex-LVMH officer called Arnault "an asset shuffler, a raider, a French Donald Trump," and after a meeting with Arnault, the chairman of Yves Saint Laurent characterized the LVMH chief as "friendly—like a bird of prey that might want to devour you."⁶ Bernard Arnault dismissed such criticism by asserting, "I'm going to run LVMH for the long term. We'll become an even stronger No. 1. My image will change."⁷

LVMH UNDER BERNARD ARNAULT

When Bernard Arnault became president of LVMH in January 1989, the company was the world's leading luxury products group with revenues of FF 16.4 billion (approximately €2.5 billion) and net income of FF 2.0 billion (approximately €300 million) in 1988. The company's business portfolio included champagnes and wines, cognac and spirits, luggage, leather goods and accessories, perfumes and beauty products, and horticulture. The 1988 revenue and operating income contributions and capital expenditures for each business unit are presented in the following table. The table also presents each business unit's percentage of sales to countries outside of France.

	Champagne and Wines	Cognac and Spirits	Luggage, Leather Goods and Accessories	Perfumes and Beauty Products	Horticulture
Sales (in millions)	FF 4,876	FF 4,083	FF 3,530	FF 3,735	FF 218
% from outside France	72%	98%	84%	74%	40%
Income from operations (in millions)	FF 1,042	FF 1,348	FF 1,458	FF 594	FF (202)
Capital expenditures (in millions)	FF 272	FF 114	FF 214	FF 170	N/A

N/A = Not available.

Source: LVMH 1988 annual report.

⁶Both quotes from "Bernard Arnault Is Building a Huge Empire—But Can He Manage It?" *Business Week*, July 30, 1990, p. 48.

⁷Ibid.

⁵Quoted in "Pivotal Figure Emerges in Moët-Vuitton Feud," *New York Times*, September 19, 1988, p. D1.

LVMH's champagne and wines business unit was the global leader in premium champagnes, with some of the oldest and most prestigious brands in the world. Dom Pérignon was arguably the world's best-known brand of champagne, Ruinart was the world's oldest champagne company, and Mercier was France's best-selling brand of champagne. Moët & Chandon, Canard-Duchêne, Veuve Clicquot Ponsardin, and Henriot rounded out LVMH's portfolio of centuries-old champagne brands. LVMH's champagne and wine division also included the respected Napa Valley sparkling wine producer Domaine Chandon. LVMH's cognac and spirits business, like its champagne and wine business unit, possessed two of the most prestigious brands worldwide with Hennessy and Hine—both founded in the mid-1700s and consistently recognized by connoisseurs for quality.

Louis Vuitton accounted for the largest share of LVMH's luggage, leather goods, and accessories division's sales, with market leading positions in luggage and travel accessories worldwide. Louis Vuitton's luggage had been popular since the mid-1800s, when Vuitton's monogrammed products first became available to affluent travelers who visited his Paris store. In 1988 Louis Vuitton leather products were available in 118 fine department stores in Europe, the United States, and Asia. Loewe was a prestigious Spanish brand that earned the distinction of Supplier to the Royal Household in 1905 and had since become noted for fine ready-to-wear leather and textile apparel, handbags, and travel accessories. Loewe also marketed a fragrance line in 1988.

LVMH's perfumes and beauty products division was composed of three different houses: Parfums Christian Dior was internationally renowned for its quality, innovation, and prestige and was the leading prestige brand of fragrance in France; the brand was also among the fastest growing in the United States and held the number one position in Western Europe. Parfums Givenchy was among the most successful prestige brands in the United States and had extended its product line to include cosmetics in 1988. RoC specialized in hypoallergenic cosmetics and was endorsed by dermatologists in Europe and the United States. RoC was the number one hypoallergenic cosmetic brand in Europe and was expected to increase sales both in Europe and the United States as LVMH expanded its distribution beyond pharmacy channels.

LVMH's horticulture group held a majority interest in Georges Delbard—one of the world's most

respected producers of high-quality rose bushes and fruit trees. The company utilized a direct sales force to market its plants to horticulture professions and operated 12 Jardineries Delbard retail stores to make its products available to consumers in France.

LVMH's Rapid Growth under Bernard Arnault

LVMH's rapid portfolio diversification began shortly after Arnault gained a controlling percentage of company shares when it acquired Givenchy Couture haute couture, men's and women's ready-to-wear fashions, and accessories in November 1988. LVMH's management had been working to unite its Parfums Givenchy with Givenchy Couture since 1987 and agreed on terms with Hubert de Givenchy just prior to Arnault's becoming president of LVMH in January 1989. In 1990 Arnault purchased an additional interest in Loewe and purchased all assets of Pommery—the largest vineyard in the Champagne Province and producer of champagnes since 1860. Arnault's most ambitious target during 1990 was Guinness PLC. Arnault increased LVMH's share in Guinness from about 12 percent to 24 percent in what was suggested by outsiders as an attempt to make LVMH the world's largest alcoholic beverage seller with more than \$5.5 billion in sales and a vast international distribution network.

Arnault abandoned his quest to gain a controlling stake in Guinness in 1994 when Guinness management agreed to a stock swap between LVMH and the British brewer that netted LVMH \$1.9 billion in cash. Arnault had initiated a few small acquisitions of fashion and spirits businesses between 1990 and 1994, but the \$1.9 billion cash infusion that resulted from the company's Guinness stock swap allowed Arnault to pursue his pledge to shareholders that LVMH was going to buy more luxury companies in cosmetics, perfume, fashion, and retailing.⁸ Arnault initially focused on L'Oréal, a leading manufacturer and marketer of cosmetics with 1993 sales of \$6 billion, and French drug manufacturer Sanofi, which bought Yves Saint Laurent in 1993. However, neither company was acquired by LVMH. Arnault brought additional fashion and fragrance brands to the company's portfolio and diversified outside of lux-

⁸Quoted in "Arnault Is Shopping," *Business Week*, February 7, 1994, p. 44.

ury goods with the purchase of three of France's leading financial and business publications—*Investir*, *La Tribune Desfosses*, and *L'Agefi*. Arnault also used the company's cash reserves to expand the number of company-owned retail stores where its Louis Vuitton and Loewe leather goods and Celine, Christian Dior, and Givenchy haute couture and ready-to-wear fashions could be found.

Bernard Arnault believed that LVMH control of the retail channels where its products were sold was critical to the success of luxury brands. The use of company-owned retail locations allowed LVMH not only to make certain its products were of the highest quality and most elegant but also to ensure that its products were sold by retailers offering the highest level of customer service. Arnault believed that ultimately the finer points of retailing impacted the overall image of luxury products as much as the products' attributes. This belief drove the company's moves into vertical integration into the operation of Louis Vuitton, Christian Dior, and other designer-label stores in Paris, New York, Beverly Hills, and other locations and also led to the \$2.5 billion acquisition of Duty Free Shoppers (DFS) in 1996. San Francisco-based DFS operated a chain of 180 duty-free boutiques in Asia and various international airports. Arnault saw DFS as an ideal acquisition candidate since the chain specialized in the sale of luxury goods to affluent international travelers and since its stores were concentrated in Asia. Asia was among LVMH's best geographic markets, accounting for as much as two-thirds of the sales of such products as Louis Vuitton luggage.

Arnault expanded further into retailing in 1997 with the acquisition of French cosmetics retailer Sephora and the purchase of a 30 percent interest in Douglas International, a German beauty-goods retailer with 190 stores in Europe and the United States. LVMH also expanded its line of fine champagnes in 1997 with the acquisition of Château d'Yquem—a brand produced with such care and under such exacting standards that each vine yielded just one glass of champagne. Arnault again made an attempt to have LVMH become the world's largest wine and spirits producer and distributor when he spent \$2.3 billion in 1997 to purchase 11 percent of Grand Metropolitan PLC—a British food conglomerate with \$1.5 billion in annual wine and spirits sales. Arnault used the ownership position in Grand Met to insert himself into merger negotiations that

were under way between Guinness and Grand Met. Arnault proposed an alternate merger scenario that would combine Guinness, Grand Met, and LVMH and make LVMH the controlling entity with a 35 percent stake in the three-way merger. Guinness and Grand Met shareholders rejected the proposal but provided Arnault with a \$400 million payoff to allow the two-way merger to proceed, an 11 percent interest in the new company, and a seat on its board of directors.

Arnault expanded LVMH's retailing operations beyond specialty retailing in 1998 with the acquisition of famous Parisian department stores La Belle Jardinière and Le Bon Marché. Arnault also added Laflachère—France's leading producer of hygiene, beauty, and household cleaning products—and Marie-Jeanne Godard, a fine fragrance line, to LVMH's portfolio in 1998, but his boldest acquisition spree occurred during 1999 and 2000. During that two-year period, Arnault created a new watch and jewelry division with the purchase of TAG Heuer, Ebel, Chaumet, and Zenith; pushed the company into makeup-artist-quality cosmetics with the purchase of Bliss, BeneFit, Hard Candy, Make Up for Ever, Fresh, and Urban Decay; and entered the fine art and collectible auction industry with the acquisition of famous auction houses Phillips, de Pury & Luxembourg, and L'Etude Tajan.

Arnault's buying binge broadened the company's media operations via the addition of a French radio network and magazines targeted to music aficionados and art connoisseurs. Other business additions included (a) New World wine producers located in the United States and Australia; (b) new retail outlets in the form of an Italian cosmetics retailing chain and Miami Cruiseline Services, which offered duty-free shopping aboard 100 cruise ships sailing in the Caribbean and elsewhere; (c) an enhanced line of champagnes with Krug, the producer of some of the world's most expensive champagnes; and (d) the fashion houses of Emilio Pucci, Thomas Pink, and Fendi.

Arnault had attempted to add Gucci to the company's impressive lineup of designer brands by purchasing more than 34 percent of the Italian fashion label's shares but was thwarted by rival French conglomerate Pinault-Printemps-Redout (PPR) when it acquired 42 percent of Gucci shares. The battle for control of Gucci pitted France's two wealthiest men, LVMH's Arnault and PPR's Francois Pinault, against

each other in a battle that would eventually be won by Pinault but would provide LVMH with more than \$1.8 billion for its stake in Gucci. LVMH's most notable acquisitions in 2001 included Donna Karan International and La Samaritaine, the largest department store in Paris. A complete list of LVMH's acquisitions and divestitures is presented in Exhibit 3.

LVMH'S APPROACH TO BUILDING SHAREHOLDER VALUE IN LUXURY PRODUCTS BUSINESSES

LVMH's corporate strategy under Bernard Arnault included diversification into a wide variety of luxury products. The company's wines, champagnes, haute couture and ready-to-wear fashions, cosmetics, fragrances, writing instruments, watches, and jewelry were among the most innovative, prestigious, elegant, and expensive produced. The company's retailing division focused on the sale of luxury items—whether LVMH products or brands offered by rival producers. The company's media division, for the most part, published periodicals of interest to the financial and art communities and its auction house specialized in the sale of fine art. LVMH's broad collection of businesses was grouped into six business units. Exhibit 4 presents LVMH's business portfolio in 2002.

Wine and Spirits

The production of extraordinary class wine and champagne required considerable attention to detail and decades-long commitment to quality. For example, Château d'Yquem's vineyards were cultivated over generations and were made up of vines grown from individually selected seeds. Also, on nine occasions during the 20th century the winery rejected an entire harvest, viewing all grapes from the season as unworthy of the brand. Wine production also required technical expertise to develop techniques to improve the immune systems of vines to prevent grape diseases and the skills of master blenders, who selected combinations of grapes that would result in exceptional vintages. Not any less important was the

time required to produce fine wines and champagnes, some of which were aged for several years prior to distribution. Distribution from production facilities to retail outlets was typically handled by either a subsidiary, a joint venture, or a third party.

In 2002 LVMH was the world's leading champagne producer, with a 22 percent global market share and a 2001 sales volume of 49.8 million bottles. The company was also number one in the global cognac market, with a 36 percent market share and a 2001 sales volume of 40.1 million bottles. Eighty-nine percent of LVMH's wine and spirits were sold outside of France. LVMH's still wine sales were becoming stronger as Newton's California wines and Mount Adam's Australian wines benefited from Moët Hennessy's international distribution network and began to gain praise from connoisseurs beyond their domestic markets. The company's champagne sales declined by 7 percent in 2001 as retailers continued to reduce inventories built up prior to 1999's millennium celebrations and as demand for champagne in the United States fell by 29 percent after the September 11, 2001, terrorist attacks on Washington, D.C., and New York City. The sales of Hennessy and Hine expanded by 6 percent as the cognac market continued to grow in the United States and Asia.

Fashion and Leather Goods

The fashion and leather industry entailed the recruitment of highly talented and creative designers who were able to create a line of apparel or accessories that appealed to some segment of consumers. Designers had a great deal of leeway with the direction of their designs since individual tastes and preferences varied considerably among consumers. For example, whereas Ralph Lauren designs tended to reflect elements of men's and women's fashion that had been popular for decades, other designers such as LVMH's John Galliano (chief designer at Christian Dior) had caught the attention of the fashion world with a line of women's wear created from newspaper. Other important elements of creating high-end apparel and leather goods included the selection of fabrics or leather and the quality of construction. LVMH's Louis Vuitton products were all hand-assembled by craftsmen who had trained for years perfecting their talents. Apparel and leather goods were distributed to either third-party retailers or company-owned retail locations.

exhibit 3 LVMH Acquisitions and Divestitures, 1987–2002

LVMH Acquisitions			
Year	Company Acquired	Principal Business	Acquisition Cost
1987	Hine	Cognac production	Not disclosed
1988	Givenchy	Haute couture, ready-to-wear fashions	FF 225 million
1990	11.4% of Guinness PLC (United Kingdom)	Brewing and spirits production and distribution	FF 8.2 billion
	10.75% of Loewe SA (Spain)	Leather goods, fashion	Not disclosed
	Pommery	Champagne production	Not disclosed
1991	67.5% of Asbach Brandy (Germany)	Brandy production	Not disclosed
	Morris E Curiel Distributing (Venezuela)	Beer distributing	Not disclosed
	Pampero (Venezuela)	Spirits production	Not disclosed
	70% of Union Cervecera (Spain)	Brewing	Not disclosed
1993	Christian Lacroix	Haute couture, ready-to-wear fashions	FF 80 million
	Kenzo	Haute couture, ready-to-wear fashions/fragrances	FF 483 million
	55% of Desfosses International	Media production, magazines, radio	FF 126 million
1994	Outstanding 50% of <i>Investir</i>	Financial magazine	Not disclosed
	49.99% of Djedi Holding (Guerlain)	Fragrances	Not disclosed
1995	An additional 41% of Fred Joaillier	Haute couture, ready-to-wear fashions	Not disclosed
	44% of Desfosses International	Media production, magazines, radio	Not disclosed
1996	An additional 76% of Loewe SA (Spain)	Leather goods, fashion	€120 million
	Outstanding interest in Djedi Holding (Guerlain)	Fragrances	Not disclosed
	Outstanding 41% of Djedi Holding (Guerlain)	Fragrances	Not disclosed
	54% of Celine SA	Haute couture, ready-to-wear fashions	Not disclosed
	Remaining interest in Fred Joaillier	Haute couture, ready-to-wear fashions	Not disclosed
	58.75% of DFS (USA)	Duty-free retail shops in Asia/Pacific, airports	\$2.6 billion
	Remaining 46% of Celine	Haute couture, ready-to-wear fashions	Not disclosed
1997	51% of Château d'Yquem	Champagne production	Not disclosed
	Sephora	Cosmetics retailing	FF 1.6 billion
	30% stake in Douglas International (Germany)	Cosmetics retailing	Not disclosed
1998	An additional 37% of Château d'Yquem	Champagne production	FF 111 million
	Marie-Jeanne Godard	Fragrances	€118 million
	Le Bon Marché	Department store in Paris	1,343,150 shares
	99% of La Belle Jardiniere	Retailer in Paris	Not disclosed
	Interest in Cie Financiere Laflachere	Household items, toiletries	Not disclosed
1999	Krug	Champagne production	FF 1 billion
	Increased interest to 52% in Cie Financiere Laflachere	Household items, toiletries	Not disclosed
	Increased interest in Gucci from 4.8% to 34.4%	Haute couture, ready-to-wear fashions	FF 7 billion
	70% of Bliss (USA)	Cosmetics production, health spas	Not disclosed
	BeneFit (USA)	Cosmetics production	Not disclosed
	Increased interest to 64% in Château d'Yquem	Champagne production	Not disclosed

(continued)

exhibit 3 (concluded)

LVMH Acquisitions			
Year	Company Acquired	Principal Business	Acquisition Cost
2000	Hard Candy (USA)	Cosmetics production	Not disclosed
	TAG Heuer (Switzerland)	Watch design and assembly	SFr 1.15 billion
	70% of Thomas Pink (United Kingdom)	Haute couture, ready-to-wear fashions	£42 million
	Ebel (Switzerland)	Watch design and assembly	Not disclosed
	Chaumet	Watch design and assembly	Not disclosed
	Majority interest in Make Up For Ever (USA)	Cosmetics producer	Not disclosed
	Zenith (Switzerland)	Watch design and assembly, mechanism production	Not disclosed
	Radio Classique & SID Editions	French radio stations, media	Not disclosed
	5% of Oxygen Media (USA)	U.S. television and Internet media	Not disclosed
	72.5% interest in Phillips, de Pury & Luxembourg	Fine art auctioning	€90 million
	Miami Cruiseline Services (USA)	Duty free cruiseline retailing	€361 million
	67% of Emilio Pucci (Italy)	Haute couture, ready-to-wear fashions	Not disclosed
	Urban Decay (USA)	Cosmetics production	Not disclosed
	Omas (Italy)	Writing instrument production	Not disclosed
	25.50% of Fendi (Italy)	Haute couture, ready-to-wear fashions, furs	€295 million
	65% of Fresh Inc (USA)	Cosmetics production	Not disclosed
	Control of Boidi (Italy)	Cosmetics retailing	Not disclosed
	60% of Newton Vineyards (USA)	Winery and vineyards	\$45 million
	An additional 5% of Oxygen Media (USA)	U.S. television and Internet media	Not disclosed
2001	MountAdam Vineyards (Australia)	Winery and vineyards	Included w/Newton
	L'Etude Tajan	Fine art auctioning	Not disclosed
	Micromania	Videogame retailing	Not disclosed
	<i>Art & Auction, Connaissance des Arts</i>	Art magazines	Not disclosed
	Majority interest in La Samaritaine	Parisian department store	Not disclosed
	Donna Karan International (USA)	Haute couture, ready-to-wear fashions	\$243 million
	Morellato (Italy)	Watch bracelet producer	Not disclosed
	50% interest in Acqua di Parma (Italy)	Fragrances	Not disclosed
LVMH Divestitures			
Year	Company Divested	Principal Business	Sales Price
1993	RoC Group	Cosmetics producer	FF 1,314 million
1997	9.43% of Guinness PLC	Brewing and spirits producer and distributor	FF 7,989 million
	50% of Christian Dior Perfumes Inc (USA)	Fragrances	Not disclosed
	Delbard Group	Roses and fruit tree producer	Not disclosed
1999	Simi Winery (USA)	Winery	Not disclosed
2001	34.4% interest in Gucci	Haute couture, ready-to-wear fashions	\$806.5 million
2002	Pommery	Champagne producer	€230 million
	45% interest in Phillips, de Pury & Luxembourg	Fine art auctioning	Not disclosed

Source: Extel Financial Limited Annual Card, April 24, 2002.

Wines and Spirits	Fashion and Leather Goods	Perfumes and Cosmetics	Watches and Jewelry	Selective Retailing	Media and Other Businesses
Moët & Chandon	Louis Vuitton	Parfums Christian Dior	TAG Heuer	Duty Free Shoppers (DFS)	L'Etrude Tajan
Dom Pérignon	Loewe	Guerlain	Ebel	Miami Cruiseline	Advertising agency
Veuve Clicquot	Celine	Parfums Givenchy	Zenith	Sephora	Press agency
Krug	Berlucci	Kenzo Parfums	Benedom—CD Montres	Le Bon Marché	Radio Classique
Mercier	Kenzo	Bliss	Fred	La Samaritaine	<i>La Tribune</i>
Ruinart	Givenchy	Hard Candy	Chaumet		<i>Investir</i>
Canard-Duchêne	Christian Lacroix	BeneFit Cosmetics	Omas		<i>Jazzman</i>
Château d'Yquem	Marc Jacobs	Urban Decay	LVMH/De Beers		<i>Le Monde de la Musique</i>
Chandon Estates	Fendi	Fresh	joint venture		<i>Défis</i>
Cloudy Bay	StefanoBi	Make Up For Ever			<i>SID Editions</i>
Cape Mentelle	Emilio Pucci	Laflachère			<i>Salon des Entrepreneurs</i>
Hennessy	Thomas Pink	Acqua di Parma			5 news-related Internet sites
Hine	Donna Karan				<i>Connaissance des Arts</i>
Newton					<i>Art and Auction</i>
MountAdam					Sephora.com
					eLUXURY.com

Source: LVMH Web site.

LVMH's Louis Vuitton was the world's leading luxury brand and the foundation of LVMH's Fashion and Leather Goods division, which had increased both sales and operating income by more than 100 percent between 1998 and 2001. LVMH's Fashion and Leather Goods division also included such prestigious brands as Kenzo, Christian Lacroix, Marc Jacobs, Berlucci, Thomas Pink, Donna Karan, Emilio Pucci, Givenchy, Celine, and Fendi. In 2001, Louis Vuitton grew by 9 percent, while the entire division grew by 13 percent. The group outpaced its key rivals by a notable margin as Prada Group's sales increased by 5 percent (the sales of the Prada brand grew by 1 percent), Hermes' sales grew by 6 percent, and Groupe Gucci's sales increased by 1 percent, while the Gucci brand grew by 4 percent. France accounted for 11 percent of the division's sales.

Perfumes and Cosmetics

Success in the global cosmetics, fragrance, and toiletry (CFT) industry was largely attributable to the ability of producers to develop new combinations of chemicals and natural ingredients to create innovative and unique fragrances and develop cosmetics that boasted product benefits beyond cleansing and moisturizing to anti-aging, antipollution, firming, and sebum regulation. The industry was highly fragmented, with various distribution channels and multiple subcategories existing within each product category. For example, within the color cosmetics category, products like eyeliner, mascara, foundation, concealer, nail polish, and lipstick could be purchased from supermarkets, drugstores, discounters, specialty retailers, department stores, or direct sellers such as Mary Kay or Avon. In addition, the sales growth rates for the subcategories of beauty products could also vary greatly. For example, between 2000 and 2001, the U.S. sales of eye shadow increased by nearly 14 percent, while the sales of foundation declined by 2 percent. The market for beauty products was also segmented by consumer demographics and by geography. Teen consumers tended to look for specific product characteristics that were very different from what was expected by baby boomers. Country-specific differences in consumer preferences and complexions further fragmented the global CFT industry, while market penetration rate created varying growth opportunities across the world.

LVMH's perfumes and cosmetics business led the European luxury segment and had outpaced in-

dustry growth by 18.0 percent in 1999, 17.5 percent in 2000, and 5.0 percent in 2001 to reach sales of 2.2 billion euros at year-end 2001. The company's growth was attributed to its strong brands, new product introductions that included Flower by Kenzo, J'adore by Christian Dior, Hot Couture by Givenchy, and Michael by Michael Kors; the addition of new American cosmetics brands such as BeneFit, Fresh, Urban Decay, and Make Up For Ever; and the success of its Sephora retail cosmetics operations. Sephora's network of stores located in Europe, the United States, and Japan carried LVMH's perfumes and cosmetics brands, which were also sold by prestigious retailers around the world. The division also included Laflachère—France's leading brand of hygiene, beauty, and household cleaning products. Even though LVMH's perfumes and cosmetics division had recorded impressive growth rates, its sales ranked it seventh in the industry and were only about one-sixth that of industry leader L'Oréal. Approximately 80 percent of the division's sales were outside of France.

Watches and Jewelry

The watch and jewelry industry was much like the fashion and CFT industries in that it was highly fragmented with multiple product categories and wide-ranging price points. The upscale segment of the industry also reflected the fashion industry's demand for quality and creative or distinctive designs. The producers of many exquisite timepieces such as Rolex, Cartier, and Patek Philippe maintained long-established lines known not only for style but also for craftsmanship and accuracy. Most manufacturers of upmarket watches also added new models from time to time that were consistent with the company's tradition, history, and style. Watch production involved the development and production of the movement (although many watch manufacturers purchased movements from third-party suppliers), case design and fabrication, and assembly. Watches were rarely sold by manufacturers directly to consumers but rather were usually distributed to independent jewelers or large upscale department stores.

LVMH's watch and jewelry division was established in 1999 with the acquisitions of TAG Heuer, Ebel, Chaumet, Benetton-Christian Dior, and Zenith. The Omas line of Italian pens was added in 2000. The company's most popular watches included TAG Heuer's Kirium F1 and Monza lines, Christian Dior's

Chris 47, and Ebel Beluga and Classic Wave. Zenith was the only Swiss watchmaker to produce chronographs without outsourcing the movement. The automatic chronograph movement utilized in its El Primero also equipped the Rolex Daytona and other fine Swiss chronographs. New watch and jewelry lines by Ebel, Christian Dior Watches, Chaumet, and Fred were scheduled for release in 2002.

The division experienced a sales decline of 11 percent during 2001 as it withdrew from contract manufacturing for third-party brands. LVMH acquired the supplier of its TAG Heuer watch bracelets and opened a TAG Heuer boutique in London in 2001. The division also opened new Fred jewelry stores in Paris, London, and Tokyo during 2001. LVMH planned to open an Omas shop in Milan and its first De Beers jewelry store during 2002. The first De Beers store would be located in London and was to be part of a worldwide chain of jewelry stores that would be operated as a joint venture between LVMH and De Beers Centenary AG, the world's largest producers of diamonds. Only 7 percent of LVMH's sales of watches and jewelry originated from France.

Selective Retailing

LVMH's selective retailing division was made up of DFS and Miami Cruiseline duty-free stores, Le Bon Marché and La Samaritaine department stores, and Sephora cosmetics stores. The division also operated upscale Galleria shopping malls located in downtown areas of major air destinations in the Asia-Pacific region and the United States. LVMH's Gallerias featured DFS stores, Sephora, and designer boutiques such as Louis Vuitton, Hermes, Chanel, Prada, Fendi, Celine, Bulgari, and Tiffany. LVMH opened two new Gallerias in 2001—one located in Hawaii and the other in Hollywood, California.

Le Bon Marché was Paris's most exclusive department store, and La Samaritaine—the city's largest department store—was being repositioned with an emphasis on upscale fashion and accessories. Sephora was the leading retail beauty chain in France and the United States, and the second largest beauty chain in Europe. In 2001 Sephora operated more than 225 stores in Europe and more than 80 stores in the United States, all of which carried LVMH's products and other prestigious brands of cosmetics, fragrances, and skin care products, including Chanel, Dolce and Gabbana, Elizabeth Arden, Hugo Boss, Naomi Campbell, Gianni Versace, and Burberry. Sephora had operated

seven stores in Japan, but withdrew from that market and from Germany in 2001. A change in strategy initiated in 2001 called for the chain to focus on country markets where it could achieve profitable growth, such as the United States, Italy, France, and Greece. LVMH believed that developing countries such as Poland and Romania also presented profitable growth opportunities for Sephora.

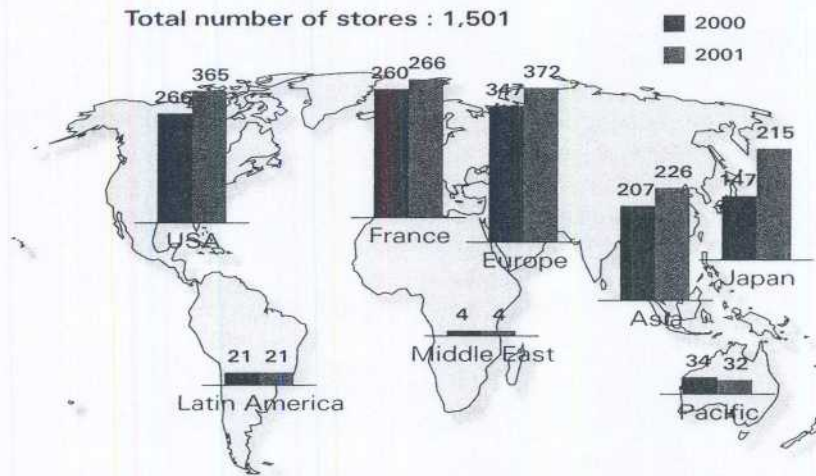
The division's 2001 sales grew by 6 percent even though the sales of DFS fell by 10 percent after tourism in the Asia-Pacific region fell by more than 50 percent after the September 11, 2001, terrorist attacks on the United States. Sephora's sales increased 23 percent during 2001 with its strongest performance coming in the United States, Portugal, Italy, France, and the United Kingdom. Exhibit 5 depicts LVMH's global network of company-owned fashion, watch and jewelry, and selective retail stores by geographic region.

Other Businesses

LVMH also maintained a business unit made up of media, art auction, and e-commerce businesses. Media operations included six print publications sold in France, two art-related publications marketed to the international art market, business newsletters, and a French radio network. The division's other media businesses included an advertising sales company, an audiovisual press agency, and four news-related Internet sites. The most prominent businesses of LVMH's media sector were *Investir*, France's leading online and print daily investment publication; Radio Classique's network of radio stations across France, which attracted 600,000 listeners a day; *Connaissance des Arts* and *Art & Auction*, which were benchmark art publications with monthly circulations of 40,000 and 17,500, respectively; and *Jazzman* and *Le Monde de la Musique*, two leading French music publications.

The company held an interest in Phillips, de Pury & Luxembourg, the world's third largest auction house specializing in fine art and antiquities, and owned L'Etrude Tajan, the leading fine art auction house in France. The group's eLUXURY Web site was launched in June 2000 and offered more than 50 of the world's most exclusive brands, including LVMH's Louis Vuitton, Dior, Fred, Guerlain, and Celine and a number of non-LVMH luxury brands. Sephora.com offered the largest and most diverse selection of beauty products on the Internet with over 11,000 products and more than 230 brands. The division's

exhibit 5 LVMH's Global Network of Retail Stores, 2000 and 2001



Source: LVMH 2001 Annual Results Presentation.

operating loss of 372 million euros in 2001 was largely attributable to Internet development costs and expansion costs at Phillips, de Pury & Luxembourg.

LVMH's performance by business group for 1999–2001 is presented in Exhibit 6.

LVMH's Corporate Strategy

Although much of LVMH's growth was attributable to the acquisition of new businesses, Arnault placed an emphasis on internal growth by exploiting common strategies and capturing strategic-fit benefits across the portfolio. Arnault based the company's strategies on a set of core values that were essential to the success of each business unit. Arnault demanded that each of the corporation's businesses demonstrate commitment to creativity, innovation, and product excellence. The long-term success of LVMH's brands, in Arnault's view, was largely a function of artistic creativity, technological innovation, and the closest attention to every detail of the production process. Innovation and creativity contributed to internal growth among LVMH's businesses, with new products accounting for more than 18 percent of Louis Vuitton's 2001 sales and more than 20 percent of LVMH's cosmetics and fragrance sales in 2001. LVMH management believed that by 2005 more than 10 percent of the company's champagne sales would be generated by 15 new cuvées introduced in 1998.

The image and reputation of the company's products were seen as equal to the creativity and craftsmanship employed during the development and production of LVMH luxury goods since image was a product dimension that defied logic but caused consumers to have strong desires for a particular brand. Arnault believed that image was priceless and irreplaceable, and that it required stringent management control over every element of a brand's image, including advertisements, corporate announcements, and speeches by management and designers.

The final element of LVMH's corporate strategy—control over the distribution and sale of its products—allowed its divisions to listen to customer needs, better understand their tastes, and anticipate their desires. LVMH's ownership of more than 1,500 retail locations in developed countries throughout the world also allowed the company to refine its brands' images with controlled store aesthetics, a consistent retailing approach, and irreproachable customer service.

Bernard Arnault discussed LVMH's strategic approach to managing its portfolio of star brands in an October 2001 *Harvard Business Review* interview:

Product Quality

The problem is that the quality of timelessness takes years to develop, even decades. You cannot just decree it. A brand has to pay its dues—it has to come to stand for something in the eyes of the world. But you can, as

exhibit 6 **LVMH's Performance by Business Group, 1999–2001**
(in millions of euros)

	2001	2000	1999
Sales			
Wine and spirits	€ 2,232	€ 2,336	€2,240
Fashion and leather goods	3,612	3,202	2,295
Perfumes and cosmetics	2,231	2,072	1,703
Watches and jewelry	548	614	135
Selective retailing	3,475	3,287	2,162
Other businesses and eliminations	131	70	12
Total	€12,229	€11,581	€8,547
Operating profit			
Wine and spirits	€ 676	€ 716	€ 655
Fashion and leather goods	1,274	1,169	826
Perfumes and cosmetics	149	184	146
Watches and jewelry	27	59	5
Selective retailing	(194)	(2)	(2)
Other businesses and eliminations	(372)	(167)	(83)
Total	€ 1,560	€ 1,959	€1,547
Capital expenditures			
Wine and spirits	€ 61	€ 66	€ 52
Fashion and leather goods	210	194	155
Perfumes and cosmetics	90	83	68
Watches and jewelry	26	16	9
Selective retailing	205	294	266
Other businesses and eliminations	392	204	24
Total	€ 984	€ 857	€ 574

Source: LVMH 2001 annual report.

a manager, enhance timelessness—that is, create the impression of timelessness sooner rather than later. And you do that with uncompromising quality.

A lot of companies talk about quality, but if you want your brand to be timeless, you have to be a fanatic about it. Before we launch a Louis Vuitton suitcase, for example, we put it in a torture machine, where it is opened and closed five times per minute for three weeks. And that is not all—it is thrown, and shaken, and crushed. You would laugh if you saw what we do, but that is how you build something that becomes an heirloom. By the way, we put some of our competitors' products through the same tests, and they come out like bouillie—the mush babies eat.

Quality also comes from hiring very dedicated people and then keeping them for a long time. We try to keep the people at the brands, especially the artisans—the seamstresses and other people who make

the products—because they have the brand in their bones—its history, its meaning. At the stores, too, many of the salespeople have the brand in their bones. Most companies clean house when they acquire a new brand. We don't do that because we have found it hurts quality terribly. When you clean house, you usher out the people who respect the brand the most and who contribute to its longevity, its timelessness, its authenticity.

Innovation

Fashion, of course, comes from innovation—the creativity of the designers. That is sometimes harder to guarantee than quality, which you can actually build in to a product, but just as important. The hard truth is, you must be old and new at once. In a star brand you honor your past and invent your future at the same time. It is a subtle balance.

If you think and act like a typical manager around creative people—with rules, policies, data on customer preferences, and so forth—you will quickly kill their talent. Our whole business is based on giving our artists and designers complete freedom to invent without limits.

Our philosophy is quite simple, really. If you look over a creative person's shoulder, he will stop doing great work. Wouldn't you, if some manager were watching your every move, clutching a calculator in his hand? So that is why LVMH is, as a company, so decentralized. Each brand very much runs itself, headed by its own artistic director. Central headquarters in Paris is very small, especially for a company with 54,000 employees and 1,300 stores around the world. There are only 250 of us, and I assure you, we do not lurk around every corner, questioning every creative decision.

The most successful creative people want to see their creations in the street. They don't invent just to invent. Yes, they come up with many exciting ideas, and many of these ideas shock; they look crazy at first, completely crazy. But the true artists that make LVMH a success, they don't want the process to end there. They want people to wear their dresses, or spray their perfume, or carry the luggage they have designed.

The responsibility of the manager in a company dependent on innovation, then, very much becomes picking the right creative people—the ones who want to see their designs on the street. And that desire inside them is something that you, as a leader of a company, can only sense. After all, most artists don't go around proclaiming, "I want to be a commercial success." They would actually hate to say that. And frankly, if you asked them, they would say they don't actually care one way or another if people buy their products. But they do care. It's just buried in their DNA, and as a manager, you have to be able to see it there. I know you are going to ask, "How can I see into a person's DNA, to know if he is an artist with commercial instincts?" So I will answer, it just takes experience. Years of practice—trial and error—and you learn.

And just as important, to allow creativity to happen, a company has to be filled with managers who have a certain love of artists and designers—or whatever kind of creative person you have in your company, if you deeply appreciate and love what creative people do and how they think, which is usually in unpredictable and irrational ways, then you can start to understand them. And finally, you can see inside their minds and DNA.

Image

Without growth, it is not a star brand, as far as I am concerned. In 2000, Louis Vuitton, which is by far the

largest luxury brand in the world, had 40% growth in sales, which makes it a superstar, no? Growth shows the shareholders that you have struck the right balance between timelessness and fashion and that you have been able to charge a premium price because of that correct balance.

Now, growth is not just a function of high price. You also grow when you move into new markets, such as those in developing countries. But mainly, growth is a function of high desire. Customers must want the product. That sounds simple, I am sure, but to get advertising right is very, very difficult—it's difficult to get advertising to represent the true brand. Most companies think it is enough to use advertising to present a picture of the product. That's not enough. You need to project the image of the brand itself.

The latest Dior ad campaign is a perfect example of how to do this right. [A Parfums Christian Dior J'adore advertisement is presented in Exhibit 7.] You would know this was an ad for a Dior product even without the name of the company there. You cannot mistake it for anything else. You know this is Dior because the model projects the image of the brand—very sexy and modern, very feminine and energetic.

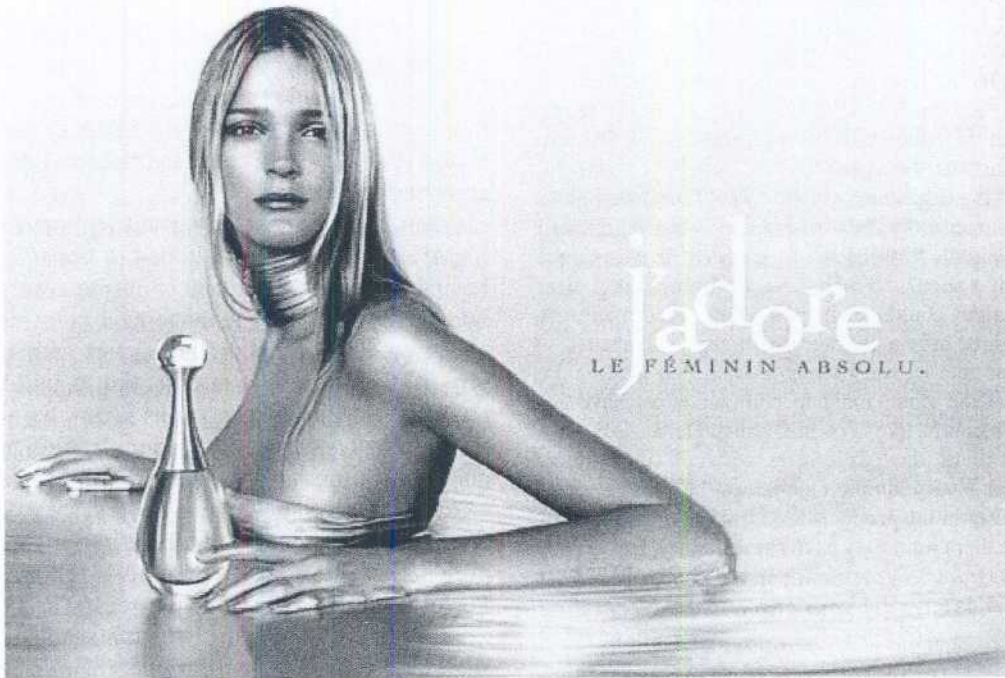
The last thing you should do is assign advertising to your marketing department. If you do that, you lose the proximity between the designers and the message to the marketplace. At LVMH, we keep the advertising right inside the design team. With the Dior campaign, John Galliano (chief designer) himself did the makeup on the model. He posed her. The only thing Galliano did not do himself was snap the photo.

Craftsmanship and the Production Process

It is true that the front end of a star brand—the innovation, supporting the creative process, the advertising, and so on—is very, very expensive. High profitability comes at the back end of the process, and behind the scenes.

It comes in the atelier—the factory. Our products have unbelievably high quality; they have to. But their production is organized in such a way that we also have unbelievably high productivity. The atelier is a place of amazing discipline and rigor. Every single motion, every step of every process, is carefully planned with the most modern and complete engineering technology. It's not unlike how cars are made in the most modern factories. We analyze how to make each part of the product, where to buy each component, where to find the best leather at the best price, what treatment it should receive. A single purse can have up to 1,000 manufacturing tasks, and we plan each and every one. In that way, the LVMH production process is the exact opposite of its creative process, which is so freewheeling and chaotic.

exhibit 7 **Advertisement for Parfums Christian Dior J'adore**



Source: Parfums Christian Dior Web site.

If you walk into a Vuitton factory, you will see very few machines. Almost every piece is made by hand. Usually, piecework is the most inefficient operating system in the world, but for us it is different because we give our craftsmen and craftswomen fantastic training. They are trained for months before they touch the products, and then, every task they do has been studied and refined for many years, so we know precisely how to arrange the atelier. No motion is wasted there. And that allows us to offer a very high quality product at a cost that makes our business very profitable.

The one catch to this system is that it takes time. You cannot rush the training of the artisans or the planning of the atelier to make a product at maximum efficiency. When we come up with a new purse, for instance, it takes months to plan a process for producing it so that it will be profitable. So sometimes customers have to wait because output is so limited. Which is why you get long lines outside your stores. And actually, that is not such a bad thing sometimes, because those lines have a way of increasing demand even further. But the main reason for the lines of customers is the combination of exceptional quality and craftsmanship at a good price.

Risk Tolerance

We don't like failures. We try to avoid them. That is why, with many of our new products, we make a limited number. We do not put the entire company at risk by introducing all new products all the time. In any given year, in fact, only 15% of our business comes from the new; the rest comes from traditional, proven products—the classics.

Vuitton is a perfect example. This year, Marc Jacobs came up with the graffiti design, and it was a big departure for the line. Did you see it? It is beautiful and crazy, right? It does not look like Vuitton at first glance; who would have thought of that on suitcases? But we only had that on several items—for which, by the way, there is now a waiting list worldwide. The rest of the products were Vuitton that you could have bought last year, or five years ago, or ten years from now. They are legacy pieces.

We will use the same approach with the new Dior handbag. It is very exciting, very expensive. You will see it in all the ads and want to buy it. I assure you we will be out of stock fast. But it is very expensive: \$1,800. We will make only several thousand of them. The rest of the line will reflect some ideas of that new purse—the same shape—but will be less

radical in terms of fabrics and design. We will make more of those and sell them for less. That way, we can have our creativity but also minimize risk.

Of course, with some businesses, you cannot avoid risk, and sometimes you do not succeed. And so you learn. With still other businesses, you cannot say they are outright failures or learning experiences, just that their success is taking time. That is the case with Christian Lacroix.

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

Capturing Synergies between Business Units

LVMH management had identified a variety of opportunities for its portfolio of businesses to share best practices, leverage competencies and skills, and combine common activities to reduce expenses. In 1999, the company created its training institute, LVMH House, in London to allow managers from different businesses, job classifications, or geographic regions to discuss such issues as leadership, technological innovation, design innovation, and operating efficiency and share their personal knowledge and experiences. By year-end 2001, more than 600 LVMH managers had attended LVMH House forums. The interactions between managers from different divisions had spawned continuing discussions of strategy and operations via the company's intranet and had initiated several intercompany projects.

Much of LVMH's Internet strategy resulted from forums held at LVMH House between May and October 2001. The theme of forum sessions focused on business-to-business, business-to-enterprise, and business-to-consumer opportunities and resulted in the formulation of strategies used in the development of LVMH's 50-plus brand Web sites and e-commerce activities at ThomasPink.com, eLUXURY.com, and

Sephora.com. The forums also helped the company implement online information exchange systems between some LVMH businesses and their suppliers and distributors. The company had successfully instituted the e-procurement of office supplies at Moët & Chandon and had created a common internal communications system called LVMH pl@net that allowed its businesses to share information through company intranets.

Among the most important competencies that LVMH management had hoped to transfer between businesses was its approach to customer relationship management. LVMH management believed that its ability to develop richer, deeper ties with a targeted group of customers was essential to building customer loyalty for its prestigious luxury brands. Relationship management entailed maintaining personal communications with customers through mail, e-mail, Internet sites, or in-store systems to transform an initial impulse purchase into more frequent purchases for larger amounts. LVMH's president of Parfums Christian Dior suggested, "The better you know your customers, the better you can define messages and actions that will trigger their desire to purchase products."⁹

Customer relationship management also allowed LVMH to pursue cross-selling opportunities between product lines. A Louis Vuitton executive explained, "A customer who bought a trendy leather goods item like a Monogram Graffiti bag is likely to be interested in our ready-to-wear lines, and should be on the list to receive special communications on our latest collection."¹⁰ In 2001, Parfums Christian Dior had conducted joint promotions with Christian Dior Couture in major department stores to introduce fragrance customers to Dior fashions. LVMH's Moët & Chandon also conducted joint promotions with the company's fashion businesses to promote its name among established purchasers of LVMH fashions by creating the Moët & Chandon Fashion Awards and the Moët Fashion Debut.

LVMH had achieved cost savings through the development of a common research and development group for its variety of fragrance and cosmetics brands. Beginning in 2000, LVMH Laboratories' 220 researchers developed beauty care, makeup, and

⁹Quoted in "Focus on Customer Relationship Management," www.lvmh.com.

¹⁰Quoted in "Special Report: Internet at the Heart of Customer Relationship Management," www.lvmh.com.

fragrance solutions for Dior, Guerlain, and Givenchy and conducted development work for Kenzo Parfums and its U.S. cosmetics brands (BeneFit, Bliss, Urban Decay, Hard Candy, and Fresh). The development of LVMH Laboratories not only allowed competencies and resources to be shared between the company's cosmetics and fragrance brands but also created a single office responsible for toxicology research and regulatory affairs.

LVMH also began implementing a common supply chain management system in its perfumes and cosmetics business in 2001 that would allow its brands to manage orders, production, purchasing, accounting, finance, and inventories. The new enterprise resource planning (ERP) system had been partially employed at Parfums Christian Dior and was expected to lead eventually to substantial improvements in margins and cash flow, out-of-stock rates, obsolescence costs, and product freshness and availability since the CFT industry required product lines that might include thousands of products. Efficient inventory management was also critical to success in the CFT industry since items were very expensive and fragile and since retailers demanded quick renewal rates.

LVMH IN 2002: LUXURY PRODUCTS AND GLOBAL ECONOMIC UNCERTAINTY

LVMH's slowing sales growth and declining profitability was, in some part, a function of declining demand for luxury goods. Its dilemma was not unlike that of other luxury goods producers like Prada, Richemont, Gucci, and Bulgari, which had all issued profit warnings in 2001. Beginning in 2000, most developed countries had experienced some economic slowdown, which was compounded by the effects of the September 11, 2001, terrorist attacks on the United States. The threat of terrorism had contributed to a decline in international travel during late 2001 and had created an emotional climate where champagne, designer fashions, and expensive timepieces seemed less important than during the boom years of the late 1990s. For example, the global sales of champagne declined by 20 percent during 2001 and the men's apparel industry declined 7 percent—falling from \$60.9 billion in 2000 to

\$54.7 billion in 2001. The chief executive of Richemont, owner of Cartier, Dunhill, and Montblanc brands, explained the state of the luxury goods industry by suggesting, "We sell the feelgood factor and there are few people in the world that feel good, especially after 11 September."¹¹

Some analysts and investors believed that LVMH's problems ran deeper than a cyclical move away from spending on big-ticket luxury items. Arnault had been criticized for his purchase of Phillips, de Pury & Luxembourg in 1999 and his subsequent attempts to unseat incumbents Sotheby's and Christie's as the world's two leaders among fine art auctioning. Some believed the move was part of an ongoing personal rivalry between Arnault and Pinault-Printemps-Redoute chairman Francois Pinault, who had purchased Christie's in 1998. Arnault had attempted to acquire Sotheby's after Pinault's acquisition of Christie's but was unable to agree on a price.

Under Arnault, Phillips, de Pury & Luxembourg undertook aggressive strategies to make a name for itself in the art auction industry such as offering generous guarantees to win prestigious consignments. However, Phillips's auctions frequently failed to meet the guarantees, leaving the art auction house liable for the shortfall. It was estimated that Phillips, de Pury & Luxembourg lost \$80 million on one auction alone. Phillips's management justified the guarantees, claiming that the tactics would allow the auction house to build market share. However, analysts questioned the overall strategy to overtake either Sotheby's or Christie's, arguing that there was not room in the fine art market for three auction houses since there were only about 50 private collectors who bought works of art for \$20 million or more. Among others, a J. P. Morgan analyst claimed, "The deal didn't make any sense to begin with. Auction houses are not luxury goods, so why bother with that?"¹² LVMH's art auction house recorded a net loss of approximately \$150 million in fiscal 2001.

Analysts and investors also questioned the company's acquisition of Donna Karan, claiming the brand did not meet Arnault's star brand criteria. Donna Karan became known worldwide during the late 1980s as her sophisticated business suits became

¹¹Quoted in "Fading Feelgood Factor Leaves Luxury Labels Tarnished," *Independent*, November 18, 2001, p. B5.

¹²Quoted in "Luxury Conglomerate Sells Its Art Auction House," *New York Times*, February 20, 2002, p. C1.

a hit with executive women and her DKNY casual wear obtained a dedicated following among urban women for after-business attire. However, beginning in 1996, Donna Karan International began to lose favor with upscale consumers as Karan's designs strayed from her traditional roots into a hodgepodge of unrelated styles. Donna Karan also pushed the company into financial distress as she spent lavishly on a New York flagship store and designs that never made it to the runway. The brand was tarnished further when Donna Karan signed licensing agreements that allowed Haggard to produce and distribute Donna Karan branded men's slacks and Van Heusen to produce and sell Donna Karan shirts. In addition, Donna Karan lost prestigious retail accounts like Neiman Marcus when DKNY liquidated its growing inventories to discounter T. J. Maxx. Arnault justified the acquisition, claiming that "what appealed to us is the fact that [Donna Karan] is one of the best-known brand names in the world."¹³

Investors also called for Arnault to examine the worth of LVMH's selective retailing businesses. DFS and Sephora had each lost approximately \$100 million during 2001, and the company's department stores in Paris required considerable capital investments and carried brands outside of LVMH's portfolio. A Merrill Lynch analyst suggested that LVMH "should focus on high-end luxury brands and not pour more money into low-margin and capital-intensive retailing."¹⁴ LVMH's head of its perfume and cosmetics business supported concerns of investors by stating, "The fact that LVMH owns DFS and Sephora is entirely neutral to my business. To be successful they have to treat competitors as they treat me. There is no synergy from having these two businesses."¹⁵

Bernard Arnault began restructuring LVMH's portfolio during the first six months of 2002, divesting more than €800 million worth of assets that included a portion of its stake in Phillips, de Pury & Luxembourg; Pommery Champagne; and certain real estate properties. LVMH's sale of Pommery

Champagne for approximately €230 million allowed it to retain the world's fifth largest champagne producer's 470 hectares of vineyards. The sales price of Phillips, de Pury & Luxembourg was not disclosed but was suggested by insiders to be less than LVMH's original €90 million investment. Arnault dismissed reports claiming that the company was considering the sale of DFS, Miami Cruiseline, Le Bon Marché, La Samaritaine, and Sephora by stating, "I do not plan to sell them in this current market—so they are not for sale"; he acknowledged, however, that "these retailing businesses are loss-making. We do not like businesses that lose money, but we know why they are losing money and we will fix them."¹⁶ Arnault also denied reports that LVMH was considering the sale of Loewe.

With Arnault controlling 48 percent of LVMH shares and a majority of shareholder votes, many analysts believed that portfolio restructuring would come slowly at LVMH. A Merrill Lynch luxury goods analyst likened Arnault's penchant for acquisitions to that of a collector of fine art (which Bernard Arnault was) observing, "Arnault has rarely sold anything."¹⁷ An ABN Ambro analyst characterized Arnault as "not a man who likes to admit he has been wrong on a number of occasions . . . so the disposal process may be slow."¹⁸ Arnault hinted that he might divest LVMH's selective retailing businesses in the future when he stated that "retailing is not a core business for LVMH" and suggested that the company would not "expand further in retailing beyond our existing plans."¹⁹ There was also some belief that, rather than retrench, Arnault might like to expand the portfolio further, with Giorgio Armani, Tiffany & Company, and Bulgari named as potential acquisition candidates.

LVMH's stock performance between 1994 and May 2002 is tracked in Exhibit 8. The company's consolidated statements of income and balance sheets for 1999 through 2001 are presented in Exhibits 9 and 10, respectively. The company's first-quarter 2002 sales of wines and spirits increased 19

¹³Quoted in *The Business*, April 7, 2002.

¹⁴Quoted in "A Veteran Dealmaker Chews Over His Core," *Financial Times*, November 21, 2001, p. 16.

¹⁵*Ibid.*

¹⁶Quoted in "Retailing Is 'Non-Core' for LVMH, Says Arnault," *Financial Times*, November 21, 2001, p. 30.

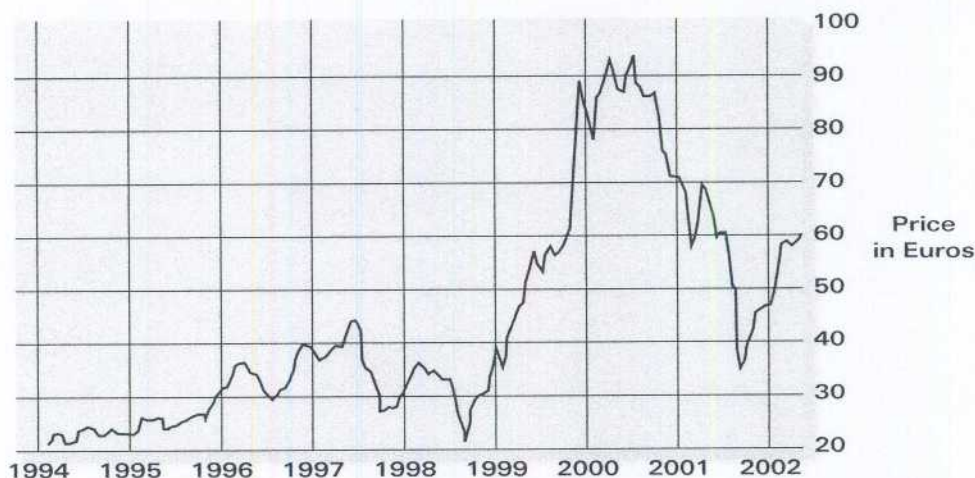
¹⁷*Ibid.*

¹⁸Quoted in "LVMH's Auction House Sale Reflects Troubles," *Daily Deal*, February 21, 2001.

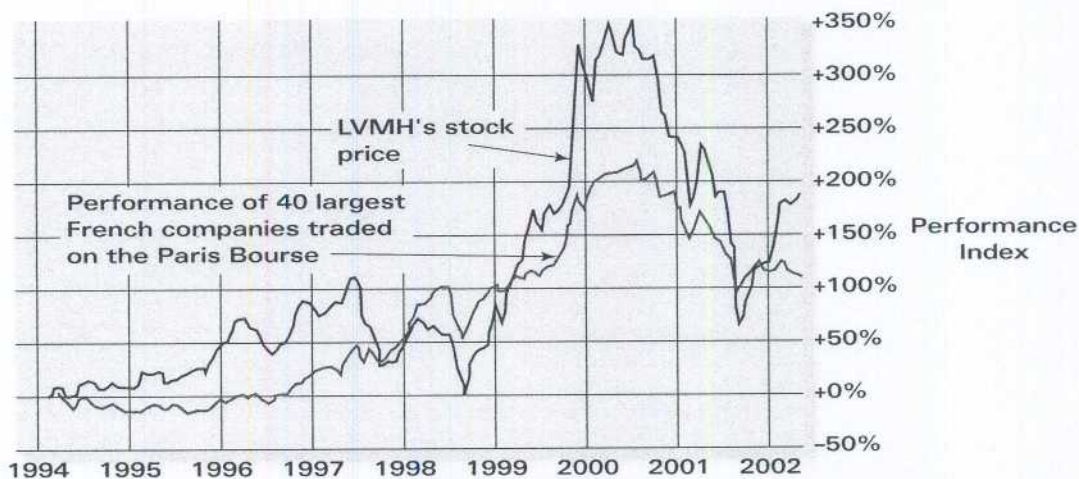
¹⁹Quoted in "A Veteran Dealmaker Chews Over His Core."

exhibit 8 **Market Performance of LVMH's Common Stock, by Quarter, 1994–May 2002**

(a) Trend in LVMH's Common Stock Price



(b) Performance of LVMH's Stock Price versus the Paris Stock Exchange



percent over those of first quarter 2001. Its first-quarter 2002 fashion and leather goods sales increased 22 percent over the same period in 2001, while the sales of its selective retailing division de-

clined by 5 percent. The company's sales of watches, jewelry, perfumes, and cosmetics remained nearly unchanged between the first quarter of 2001 and the first quarter of 2002.

exhibit 9 **LVMH's Statements of Income, 1999–2001 (in millions of euros, except per share amounts)**

	2001	2000	1999
Net sales	€12,229	€11,581	€8,547
Cost of sales	4,654	4,221	3,132
Gross margin	7,575	7,360	5,415
Marketing and selling expenses	4,568	4,206	2,964
General and administrative expenses	1,447	1,195	904
Income from operations	1,560	1,959	1,547
Financial expense—net	459	421	227
Dividends from nonconsolidated investments	21	45	97
Other income or expense—net*	(455)	109	18
Income before income taxes	667	1,692	1,435
Income taxes	192	633	554
Income (loss) from investments accounted for using the equity method	(42)	(34)	(6)
Net income before amortization of goodwill, minority interests, and unusual items	433	1,025	875
Amortization of goodwill	168	141	102
Net income before minority interests and unusual items	265	884	773
Minority interests	(99)	(179)	(137)
Net income before unusual items	166	705	636
Unusual items†	(156)	17	57
Net income	€ 10	€ 722	€ 693
Earnings per share before amortization of goodwill, minority interests, and unusual items	€ 0.89	€ 2.11	€ 1.81
Fully diluted earnings per share before amortization of goodwill, minority interests, and unusual items	€ 0.89	€ 2.11	€ 1.81
Earnings per share	€ 0.02	€ 1.49	€ 1.43
Fully diluted earnings per share	€ 0.02	€ 1.49	€ 1.43
Average number of common shares outstanding during the year	488,064,659	484,800,930	483,157,146
Number of common shares and share equivalents after dilution	488,072,374	484,886,474	483,445,278

*Other income and expenses include the results linked to LVMH's treasury shares; in 2001, this item included 39 million euros of realized capital gains and a 343 million euro provision for depreciation of the shares held at year-end. For 2000, LVMH recorded 115 million euros of capital gains from the sales of its treasury shares. In 2001, this item also includes various asset write-offs, notably for unconsolidated equity investments.

†Unusual items include €864 million of proceeds from Gucci, which include €774 million in capital gains from the disposal of these shares and €90 million for an exceptional dividend received in the fourth quarter. Unusual charges included €446 million in restructuring provisions, €385 million of which was for Selective Retailing in order to lower the break-even point of these companies, which are very sensitive to economic fluctuations. Exceptional asset depreciation totaling €480 million was also recorded. This figure includes €323 million for DFS goodwill, €83 million on the Bouygues equity stake and €60 million on the Group's unconsolidated equity investments in the new technologies business. Lastly, the balance includes notably a charge for the sale of LVMH's controlling stake in Phillips, de Pury & Luxembourg to its current principals at December 31, 2001, including a full write-off of goodwill. Unusual items are disclosed net of a €71 million positive tax effect. The €57 million unusual income item for 1999 reflects the €315 million gain realized as a result of the Diageo share buy-back program, to which LVMH tendered 143 million shares. This was partly offset by indirect charges related to the acquisition of equity interests; by a provision related to the residual interest in Diageo; by reorganization costs related to Fashion activities and logistics; and by asset depreciations, primarily related to intangible assets.

Source: LVMH 2001 annual report.

exhibit 10 LVMH's Balance Sheets, 1999–2001 (in millions of euros)

	2001	2000	1999
Assets			
Current assets			
Cash and cash equivalents	€ 795	€ 695	€ 546
Short-term investments	622	1,326	183
Treasury shares	1,046	1,289	853
Trade accounts receivable	1,538	1,638	1,442
Deferred income taxes	544	266	273
Inventories	3,655	3,382	2,943
Prepaid expenses and other current assets	1,352	1,596	1,500
Total current assets	9,552	10,192	7,740
Investments and other assets circulant			
Investments accounted for using the equity method	77	21	10
Unconsolidated investments and other investments	1,386	1,892	3,959
Treasury shares	318	156	210
Other noncurrent assets	467	307	251
Property, plant and equipment, net	4,208	3,367	2,856
Brands & other intangible assets, net	4,308	3,415	2,527
Goodwill, net	3,516	3,842	3,181
Total, other assets	14,280	13,000	12,994
Total assets	<u>€23,832</u>	<u>€23,192</u>	<u>€20,734</u>
Liabilities and stockholders' equity			
Current liabilities			
Short-term borrowings	€ 3,765	€ 5,333	€ 4,439
Accounts payable	1,401	1,305	1,087
Accrued expenses and other current liabilities	2,622	2,371	2,548
Income taxes	—	318	139
Current portion of long-term debt	238	235	161
Total current liabilities	8,026	9,562	8,374
Net deferred income taxes	169	110	167
Long-term liabilities			
Long-term debt, less current portion	5,402	3,498	3,085
Other long-term liabilities	1,250	1,164	921
Repackaged notes	284	346	406
Total long-term liabilities	6,936	5,008	4,412
Minority interests in subsidiaries	1,800	1,481	1,077
Stockholders' equity			
Common stock	147	147	147
Additional paid-in capital and retained earnings	6,894	7,017	6,679
Cumulative translation adjustment	(140)	(133)	(122)
Total stockholders' equity	6,901	7,031	6,704
Stockholders' equity and minority interests	8,701	8,512	7,781
Total liabilities and stockholders' equity	<u>€23,832</u>	<u>€23,192</u>	<u>€20,734</u>

Source: LVMH 2001 annual report.