

Case 3 Kering SA: Probing the Performance Gap With LVMH

In March 2013, the French fashion and retail giant Pinault-Printemps-Redoute (PPR) changed its name to Kering. According to CEO François-Henri Pinault: “Kering is a name with meaning, a name that expresses both our purpose and our corporate vision. Strengthened by this new identity, we shall continue to serve our brands to liberate their potential for growth.” The change in name followed the transformation in the business of the company.

PPR was primarily a retailing company: it owned the department store chain Au Printemps, the mail-order retailer La Redoute, and the music and electronics chain Fnac. However, the acquisition of 40% of the Gucci Group in 1999 (later increased to 99.4%) marked the beginning of a transformation from being a retailing company to a fashion and luxury goods company. Table 1 shows the main acquisitions and divestments of PPR/Kering.

This was not the first transformation that the company had undergone. PPR/Kering was the creation of the French entrepreneur François Pinault who had established Pinault SA as a timber trading company before acquiring retailers Au Printemps and La Redoute. In March 2005, François Pinault was replaced by his son, François-Henri Pinault—a graduate of HEC School of Management—as chairman and CEO of Kering. The Pinaults’ dominance of Kering is ensured through the role of the Pinault family’s holding company, Groupe Artémis, which owns 40.9% of Kering. (Artemis also owns Christie’s, the auction house, and the Château Latour vineyards.)

In recreating itself as a diversified fashion and luxury goods company, Kering has been widely viewed as modeling itself on LVMH—the world’s leading purveyor of luxury goods. However, despite the close parallels between the two companies—and their leading families, the Pinaults and the Arnaults—Kering has underperformed LVMH. During the ten-year period under the leadership of François-Henri Pinault (March 2005 to March 2015), Kering’s share price growth was 121% compared to 271% for LVMH. Kering’s revenues had declined by 41% over the period, compared to LVMH’s growth of 100%, while operating profit had grown by 21%, compared with 67% for LVMH. (Figure 1 charts changes in Kering’s share price.) It was widely believed that LVMH’s superior performance would continue: of the investment analysts surveyed by the Financial Times during summer 2015, 62% rated LVMH as a “buy” or “outperform” as compared with 36% for Kering.

Efforts to boost Kering’s performance included a shakeup of the management of Gucci—chief executive Patrizio di Marco was replaced by Marco Bizzarri and Creative Director Frida Giannini by Alessandro Michele—and exploring the

TABLE 1 Kering's principal acquisitions and divestments, 2000–2014

Year	Business
2000	Acquisition of Boucheron (jewelry and perfumes)
2001	Acquisition of Bottega Veneta and Balenciaga
	Launch of Stella McCartney and Alexander McQueen brands
2004	Ownership of Gucci Group increased to 99.4%
	Sale of Facet (financial services), Rexel (distributors of electrical equipment)
2006	Sale of Printemps
2007	Acquisition of 62% of Puma
2009	Acquisitions of Dobotex (manufacturer of Puma socks and apparel) and Brandon (corporate merchandising)
2010–2011	Acquisitions of Cobra and Volcom (sports equipment suppliers) and luxury menswear supplier, Brioni
2012	Divestment of Fnac
	Sale of Redcats online businesses
	Joint venture formed with Yoox for online sales of luxury brands
2013	Acquisition of Christopher Kane (fashion clothing), Pomellato (jewelry) and France Croco (processor of crocodile skins)
	Sale of La Redoute and Relais Colis (parcel delivery)
2014	Acquisition of Ulysse Nardin (watches)

Source: Tables 1, 2, 3, A1 and A2 are based upon information in Kering Financial Documents for 2014, 2012, and 2010.

possible sale of its sportswear company, Puma. However, if Kering was to close the performance gap between itself and LVMH, a critical first step was to understand the sources of that performance differential.

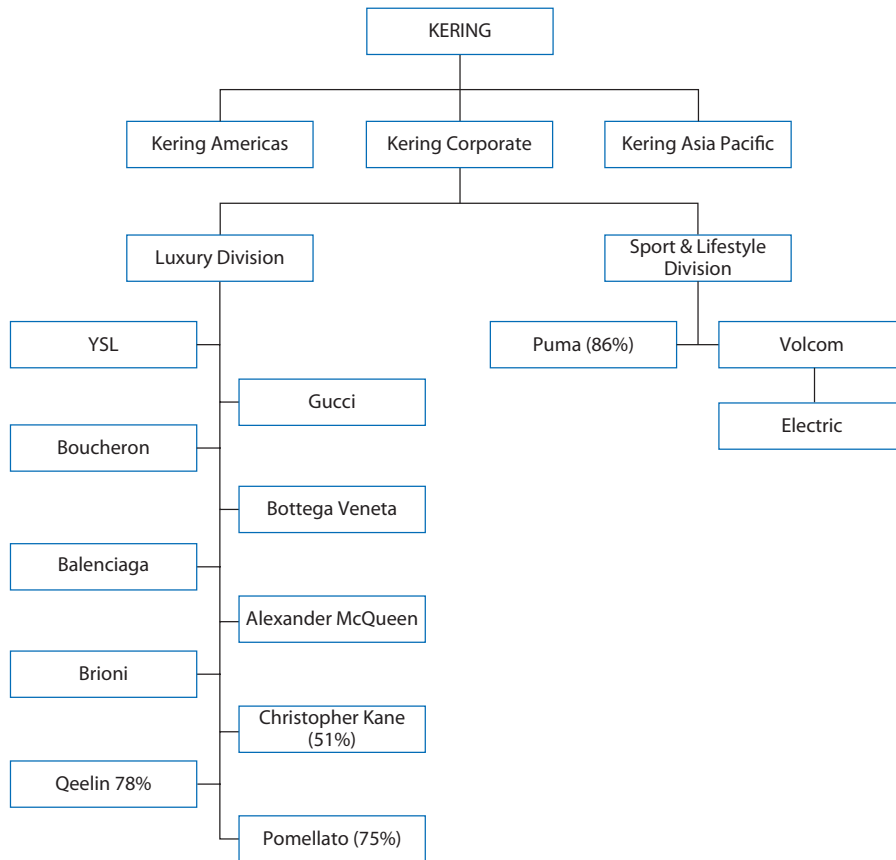
Kering in 2015

In 2015, Kering SA operated in two segments:

- Luxury: designs, manufactures, and markets ready-to-wear clothing, leather goods, shoes, watches, jewelry, fragrances, and cosmetic products through a number of high-profile brands.

FIGURE 1 The share price of PPR/Kering, 2000–2015

Source: Yahoo! Finance.

FIGURE 2 Kering Group: Simplified organizational chart, January 2015

Source: Kering Financial Document, 2014.

- Sport & Lifestyle: designs and develops footwear, apparel, and accessories under the Puma, Volcom, and Electrics brands.

Figure 2 shows Kering’s organizational structure. Table 2 shows the performance of major brands.

Table 3 shows revenue by geographical region.

Kering’s states that its mission is “To offer products that enable its customers to express their personality. To reach this goal, the Group empowers an ensemble of powerful, complementary brands to reach their full potential, while ensuring that each of them stays true to its own values and identity—this is what Kering calls *Empowering Imagination*.”¹

Kering’s strategy comprises a combination of organic and external growth:

- Organic growth involves “(i) launching new product categories and continuously refining existing lines; (ii) strengthening distribution channels through selective expansion of directly-operated store networks, close relationships with third-party retailers, and implementation of a dynamic e-commerce strategy; (iii) enhancing sales performance, notably through increasingly efficient

TABLE 2 Kering Group: Performance of the major brands (€ millions)

Brand	Revenue		Op. Income ^a		Op. margin		Net assets	
	2014	2013	2014	2013	2014	2013	2014	2013
Gucci	3497	3561	1056	1132	30.2%	31.8%	6373	6355
Bottega Veneta	1131	1015	357	331	31.6%	32.5%	1072	532
Saint Laurent	707	557	105	77	14.9%	13.8%	547	1005
Other luxury brands	1424	1337	147	144	10.3%	11.6%	2551	1935
Total Luxury Division	6759	6378	1666	1684	24.6%	26.4%	10542	9826
Puma	2990	3002	128	192	4.3%	6.4%	4399	4335
Other sport/lifestyle brands	255	245	10	9	3.7%	3.5%	277	418
Total Sport & Lifestyle Division	3245	3247	138	200	4.2%	6.2%	4675	4753

Note:

^aRecurrent operating income. Excludes impairment of goodwill, restructuring costs, etc.

merchandising, in-store excellence, sophisticated customer intelligence, and relevant, well-targeted communications.”² For example, in 2014 Gucci launched a range of cosmetics. Another strategic initiative is the development of an integrated approach to eyewear comprising an internal value chain for product development, supply chain management, brand strategy, and sales and marketing.

- External growth involves acquiring brands with “exceptional brand identity, well-rooted values and a sought-after legacy; a unique scope of expression through lasting codes and language, often referred to as their DNA; an ability to broaden their territories independently or through alliances; and an aptitude to gradually expand their market coverage beyond their current borders.”³ For example, Kering’s acquisition of watchmaker Ulysse Nardin was based upon its complementary relationship with Kering’s other watch brands and Ulysse Nardin’s potential for geographical expansion, especially in Asia-Pacific.

Synergies across Kering’s businesses are achieved through:

- Talent development and deployment: “The idea behind the HR strategy is for the brands to flourish through access to a shared talent pool [which] primarily targets the top 200 managers of the Group.”⁴

TABLE 3 Kering Group: Sales revenue by geographical region

	2014 €million	2013 €million	Reported change (%)	Comparable change (%) ^a
Western Europe	3,152	3,022.0	+4.3	+1.6
North America	2,147	2,032	+5.7	+5.5
Japan	963	968	-0.5	+7.3
Eastern Europe, Middle East and Africa	728	710	+2.7	+4.9
South America	465	475	-2.2	+9.0
Asia-Pacific (excluding Japan)	2,583	2,449	+5.4	+5.3
Total revenue	10,038	9,656	+4.0	+4.5

Note:

^aChange in revenue after correcting for changes in exchange rates.

- An e-business strategy developed initially for Gucci but then extended to each of Kering's brands.
- A group-wide approach to sustainability that “represents long-term differentiation and competitive advantage by offering new business development opportunities, stimulating innovation and in many cases helping to reduce costs. It is also a motivating factor for the employees ... The Kering sustainability department acts as a platform of resources to accompany the brands' own activities.”⁵

Appendix 1: Kering SA: Selected Financial Data⁶

TABLE A1 Selected items from the financial statements of Kering SA, year to 31 December (€million)

	2014	2013	2012	2011	2010
INCOME STATEMENT					
Total revenue	10,038	9,656	9,736	8,062	11,008
Cost of sales	3,742	3,615	3,776	3,087	5,639
Selling, general and admin. expenses	1,545	1,516	1,494	1,229	1,637
Non-recurring net expenses	112	441	25	24	98
Other operating expenses, total	3,087	2,774	2,675	2,245	2,405
Total operating expense	8,486	8,345	7,970	6,584	9,779
Operating income	1,552	1,311	1,766	1,478	1,229
Net income from continuing operations	1,008	874	1,324	968	709
Net income from discontinued operations	(479)	(825)	(276)	18	255
Net income	529	50	1,048	986	965
BALANCE SHEET					
Assets					
Cash and short-term investments	1,196	1,527	2,168	1,316	1,449
Total receivables, net	1,168	1,069	1,061	1,183	1,317
Total Inventory	2,235	1,806	1,737	2,203	2,227
Total current assets	5,273	4,925	5,460	5,277	6,940
Property, plant, and equipment	1,887	1,677	1,376	1,372	1,424
Goodwill, net	4,040	3,770	3,871	4,215	4,540
Brands and other intangibles	10,748	10,703	10,490	10,331	10,200
Total assets	23,254	22,811	25,257	24,954	24,695
Liabilities					
Accounts payable	983	766	685	1,536	1,928
Notes payable/short-term debt	1,254	540	362	892	372
Current portion long-term debt/capital leases	1,247	1,310	1,223	1,095	1,799
Total current liabilities	5,780	4,559	4,381	7,072	6,495
Total long-term debt	3,195	3,133	2,989	3,066	3,148
Total debt	5,696	4,982	4,212	5,053	5,319
Total liabilities	12,620	12,224	13,843	14,029	14,095
Total shareholders' equity	10,634	10,587	11,414	10,925	10,599
CASH FLOWS					
Net cash from operating activities	1261	1521	1366	1,332	1,264
Total cash from investing of which	(903)	(966)	259	402	79
—Capital expenditures	(551)	(675)	(442)	(325)	(305)

TABLE A2 Kering Group: Divisional information

Brand	Luxury		Sport & Lifestyle	
	2014	2013	2014	2013
Brand value (€m)	6578	6629	3887	2523
Goodwill (€m)	2944	2523	1096	1247
Number of stores	1173	1088	677	608
Number of production & logistic units	140	110	44	51
Divisional revenue by product	6759	6378	1666	1684
Apparel (%)	16	16	40	43
Footwear (%)	12	13	40	39
Leather goods (%)	53	54	--	--
Watches & jewelry (%)	10	9	--	--
Other (%)	9	8	20	18
Divisional revenue by region				
W. Europe (%)	32	33	30	30
N. America (%)	19	19	26	25
Asia Pacific (%)	31	31	14	13
Japan (%)	10	10	9	10
Other (%)	8	7	21	22

Appendix 2: LVMH: Selected Financial Data

LVMH Moët Hennessy Louis Vuitton SA (LVMH) is a Paris-based luxury goods company. Tables A3 to A5 show financial data for the company and its main businesses.

TABLE A3 LVMH's businesses and brands^a

Division	Revenue (€million)		Op. profit (€million)		Major brands
	2014	2013	2014	2013	
Wines and Spirits	3,973	4,187	1,147	1,370	Moët & Chandon, Dom Pérignon, Veuve Clicquot, Krug, Ruinart, Mercier, Château d'Yquem, Château Cheval Blanc, Hennessy, Glenmorangie, Ardbeg, Wen Jun, Belvedere, Chandon, Cloudy Bay
Fashion and Leather Goods	10,828	9,882	3,189	3,140	Louis Vuitton, Céline, Loewe, Kenzo, Givenchy, Thomas Pink, Fendi, Emilio Pucci, Donna Karan, Marc Jacobs, Berluti, Nicholas Kirkwood, Loro Piana
Perfumes and Cosmetics	3,916	3,717	415	414	Christian Dior, Guerlain, Parfums Givenchy, Parfums Kenzo, Loewe Perfumes, Benefit Cosmetics, Make Up For Ever, Acqua di Parma
Watches and Jewelry	2,782	2,784	283	375	Bulgari, TAG Heuer, Chaumet, Dior Watches, Zenith, Fred, Hublot, De Beers Diamond Jewellers Ltd (a joint venture)
Selective Retailing	9,534	8,938	882	901	DFS, Sephora, Le Bon Marché, la Samaritaine, Royal Van Lent

Note:

^aNet assets by business in 2014 were: Wines and Spirits €10,543m; Fashion and Leather €9,484m; Perfumes and Cosmetics €1,397m; Watches and Jewelry €7,196m; Selective Retailing €4,849m.

Source: Tables A3, A4, and A4 are based upon LVMH Annual Reports for 2014, 2012, and 2010.

TABLE A4 LVMH's revenues by geographical region, 2014 (€million)

France	3,212
Europe (excluding France)	5,830p
Asia (excluding Japan)	8,740
Japan	2,107
United States	7,262
Other countries	3,487

TABLE A5 Selected items from financial statements of LVMH (€million)

	2014	2013	2012	2011	2010
INCOME STATEMENT ITEMS					
Total revenue	30,638	29,016	27,970	23,659	20,320
Cost of sales	10,801	9,997	9,863	8,092	7,184
Selling, general, and admin. expenses	14,117	12,979	12,164	10,304	8,815
Non-recurring net expenses	289	116	174	95	155
Operating income	5,431	5,898	5,742	5,154	4,169
Net income	5,648	3,436	3,425	3,065	3,032
BALANCE SHEET ITEMS					
Cash and short-term investments	4,091	3,397	2,187	2,448	2,511
Total receivables, net	2,628	3,132	2,173	2,750	2,155
Inventory	9,475	8,492	7,994	7,510	5,991
Total current assets	18,110	15,971	14,167	13,267	11,199
Property, plant, and equipment	10,387	9,621	8,694	8,017	6,733
Goodwill, net	8,810	9,058	7,709	6,957	5,027
Brands and other intangibles	13,031	12,596	11,322	11,482	9,104
Total assets	53,362	56,176	49,850	47,113	37,164
Accounts payable	3,606	3,297	3,118	2,952	2,298
Notes payable/short-term debt	—	3,661	—	1,825	823
Current portion long-term debt/capital leases	4,189	1,013	2,950	1,219	1,011
Total current liabilities	12,175	11,639	9,405	9,594	7,060
Total long-term debt	5,054	4,149	3,825	4,132	3,432
Total debt	9,243	8,823	6,775	7,176	5,266
Total liabilities	31,599	29,297	25,426	24,742	19,966
Shareholders' equity	21,763	26,879	24,424	22,371	17,198
CASH FLOWS					
Net cash from operating activities	4,607	4,714	4,115	3,907	4,049
Total cash from investing of which	(2,007)	(3,917)	(1,690)	(3,016)	(2,691)
—Capital expenditures	(1,775)	(1,657)	(1,694)	(1,749)	(1,002)

Notes

1. Kering Financial Document 2014: 8.
2. Ibid.: 8.
3. Ibid.: 9.
4. Ibid.: 10.
5. Ibid.: 11.
6. LVMH 2014 Annual Report.