LUXURY INSTITUTE LLC

The Knowledge of Luxury

Luxury Institute's Five Critical Skills Required to Successfully Scale a Luxury or Premium Conglomerate

(NEW YORK) March 20, 2018 – Consolidating luxury and premium goods and services brands into groups is becoming even more popular today, as the rate of change in a hyper-competitive business environment continues to create major challenges and huge opportunities. Luxury groups such as LVMH, Kering, Richemont and Swatch Group have been successful leaders in growth through acquisitions. Now a multitude of other large and small groups have joined the party, including Tapestry, Michael Kors, and several private equity firms. Building luxury groups, however, is only a wise strategy if these businesses possess the critical skills to deliver the massive potential benefits.

Over the decades, there has been a raging debate as to whether building a conglomerate, or a "group," is a good idea, or whether operating as a singular brand is best. The argument against building a group can be summed up in two terms: unmanageable size and overwhelming complexity. The result is known as "diworsification." In contrast, the case for building a group today often hinges upon achieving the clear benefits of diversification and back office efficiencies. In theory, some brands in the portfolio may be lagging or growing slowly in any given year, but most will be thriving. Luxury Institute CEO Milton Pedraza, who has worked with all of the luxury groups over the past 15 years, believes there are many other benefits that can be derived from creating a group that are often ignored. There is a perceived false choice between command-and-control and hands-off group leadership. Pedraza believes there is a clear third way to provide the group's brands with freedom with structure and accountability. The critical role of group management, according to Pedraza, is to help the entire brand network to navigate between rigidity and chaos in the zone of optimal integration.

Warren Buffett, chairman of Berkshire Hathaway, may be the most successful conglomerate builder in history. His approach is to have a super-lean headquarters team while empowering his diversified portfolio of companies across highly disparate industries to operate independently. Buffet's "hands-off" approach makes sense given the huge business model differences between industries as diverse as insurance, soft drinks, financial services, and railroads in the Berkshire portfolio. Buffett is an investor, not a manager.

The luxury and premium groups are not just investors. They are, first and foremost, brand stewards. Pedraza suggests that groups are leaving huge amounts of money on the table by failing to understand what elements of brand building they should delegate to brand leaders, and where they should fully leverage functional and operational expertise across the entire group. One key skill is the wisdom to know the difference. For example, the founding DNA and creative talent of each brand should always be empowered to remain fiercely independent in

order to preserve and maintain the uniqueness and identity of each brand. However, many other areas require group stewardship.

Here are Luxury Institute's five recommended critical skills required to successfully acquire brands and to profitably scale up a luxury or premium brand group:

1: Rigorous focus around category segments of expertise and focus on affluent target consumers

While there are exceptions to every rule, one clear success factor is to make acquisitions only in areas where you have both deep and proven expertise, and those in which you can achieve critical size. The top performing groups tend to cluster their brand portfolios across certain types of categories within common themes, such as apparel, accessories, wines and spirits, beauty, or some combination that has a clear fit. They also focus on affluent consumers regardless of their other demographics.

Without this focus, groups tend to underperform. For example, Richemont has done a brilliant job of managing its luxury jewelry and watches portfolio, even in the toughest of times. They have not done as well in apparel, recently selling Shanghai Tang, and putting up Lancel for sale. Acquiring Yoox Net-A-Porter, which has tremendous size and leverage in its space, is a high-probability move. Focus matters.

2: Surgical talent selection, engagement, development and retention

Group brands often use completely different methods for selecting talent and engaging, educating, and retaining employees, even within the same brand's regions or locations. While there should always be room for experimentation and novelty, companies today have the benefit of decades of neuroscience studies and the science of high-performance to leverage human capital best practices across all brands. Leveraging the best methods and principles leaves plenty of room for brand and individual creativity. What's critical is creating a human capital lab within the group, which gathers evidence-based best practices and works with brands to assign valid and reliable beta tests of innovative and promising practices. The results should be leveraged across the group rapidly. Joint ventures with outside universities, institutes, and scientists can all be part of the mix. LVMH is a best practitioner in surgically attracting, selecting, and developing executive talent throughout its group staff, and with the assistance of outside experts. Even the smallest brands should perform at the pinnacle of human capital management when they are members of a group.

3: Optimal supply chain, distribution and channel management

There are common best practices in supply chain, distribution and channel management that are obvious and available to all brands in the luxury and premium categories. Too often, however, Luxury Institute has found that particular brand teams, especially smaller brands in a

group, lack expertise in sourcing and manufacturing products, managing inventories, and optimizing distribution channels. They make predictable mistakes. Pedraza believes it is the group's fiduciary responsibility to deploy the absolute best objective experts to evaluate each brand's needs, and to adopt best practices across the network with economies of scale. The reason why a brand portfolio outperforms should be based on the fact that belonging to the group confers massive supply chain advantages and other economies of scale to even the smallest brands.

4: Pinpoint technology, data and analytics expertise

Artificial Intelligence is now all the rage, but not long ago it was Big Data and analytics, and before that it was CRM. There are so many technology companies offering so many varieties of SaS (software as a service) retail solutions that it can be a challenge to figure out what technology is the right fit, how to integrate it, and how to derive the benefits.

Technology, data, and analytics are critical assets for brands, and are even more important for the group. Groups can execute on the opportunity to take over this area of expertise and implementation, but they must develop task forces comprised of top internal and external experts, plus multi-brand executives, and deal with the issues as a group. Only the power of a group can ensure that selected vendors for the same needs are best in class, are held accountable to the absolute highest performance standards, across all brands, with iron-tight contractual clauses and unflinching advocacy. Tying group team compensation directly to brand results, along with performance standards, plus rapid deployment project management methods, can save hundreds of millions in wasted, misfit, or underutilized technology over time.

5: Social Responsibility

Social responsibility is comprised of three branches. First is the requirement that a brand and its people behave ethically, internally and externally, across the brand ecosystem. Second is that the brand must be environmentally friendly and promote sustainability. The third is that the brand should be charitable and substantively promote social causes. When a brand belongs to a group, this should not be optional. It should be integrated into the DNA of each member of the group. Kering is a best-in-class example of social responsibility. From its chairman, François-Henri Pinault, known for his humility, emotional intelligence and generosity, to its board of directors, nearly two-thirds of which are top-tier women, social responsibility is a hallmark of the group. It produces an annual environmental P&L, and group brands contribute heavily to social causes. Brands have flexibility in selecting their valued causes, but the group should always review and audit the results. Being socially responsible is not only a brand reputation builder. It reflects upon the reputation and value of the entire group.

In private, group executives across the world agree that there are many underleveraged opportunities in luxury and premium groups. Often, they say, egos get in the way of

optimization. If groups are complex adaptive systems, living in a large and unpredictable ecosystem, then the rapid-response adaptability and agility of the group must be optimized. The major responsibilities of the group leadership team are selecting the right, open-minded people to be brand stewards, determining what critical elements of the business model require standardization across brands, and which critical elements need to be totally free in order to inspire differentiation, novelty, experimentation, and innovation. Having the skill and wisdom to know the difference will determine the destiny and longevity of each group.

To learn more, contact us at Luxury Institute or Milton Pedraza, Luxury Institute CEO, directly with questions.