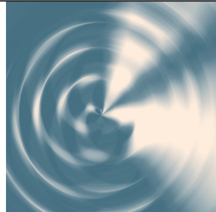
Elisa Giacosa

Mergers and Acquisitions (M&As) in the Luxury Business



Business Combinations as a Means of Company Growth

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To Greg's Grandmothers

Introduction

Considering the luxury sector as an élite phenomenon, the reference target is represented by an élite group of extra-rich people. Due to luxury democratization, luxury is becoming a prerogative of a less restricted range of people, bringing growth potential to luxury companies. Businesses operate in three different luxury levels: non-affordable luxury, intermediate luxury and affordable luxury.

Affordable luxury is the origin of "new luxury": customers who generally cannot afford a luxury product allow themselves to buy one occasionally, as in a sort of "treasure hunt".

Luxury democratization occurs through the "trading-up" phenomenon: customers make a choice in a scale of desires, where luxury products belong to different merchandise categories.

The global financial crisis has influenced the luxury sectors, but the luxury market has recently begun a new growth phase also due to the affordable luxury. Therefore, luxury business is a rather interesting context for business combinations as a means for the company growth, given the trends in global luxury consumption and forecasts.

The book focuses on the analysis of the particular characteristics of *management of companies in luxury business*, especially to support a profitable growth.

It also analyzes *M&As in the luxury context* which has shown its attitude towards increasing its appeal even towards "day trippers" and new emerging markets.

The *first chapter* describes the context of the luxury business, which is compared to the fashion one in order to identify differences and similarities. In addition, it analyses the environment in which luxury companies operate, as this environment is a source of restrictions and opportunities for the management. However, companies might in turn have an impact on their context, since they generate new trends in human needs. The chapter ends with an outline of the various sectors involved in the luxury business, with a distinction made between core luxury sectors and emerging luxury ones.

The *second chapter* contains a detailed description of the different types of luxury, i.e. nonaffordable luxury, intermediate luxury and affordable luxury. Each form targets a different segment, thereby creating a considerable diverse offer in terms of quality, innovation and creativity. In particular, the offer of luxury products is examined on the basis of the variables related to the marketing mix, i.e. product, price, promotion and place. This analysis is followed by a typification of managerial choices in luxury companies.

The *third chapter* focuses on the trends characterising the luxury business. Various growth drivers allow for the identification of the factors that have been crucial in the luxury business in the last few years. Global trends are examined in order to identify the most appealing markets in terms of opportunities for the company. In addition, this chapter touches on counterfeiting, which significantly affects the luxury business. The quantification of this phenomenon is rather difficult because of its illegal nature and global diffusion, not to mention the fact that illegal traffic in counterfeit products cannot be thoroughly traced.

The *fourth chapter* outlines growth opportunities for luxury companies. Growth might be achieved both externally and internally. The chapter compares the various strategies that companies might implement, in order to identify their strengths and weaknesses. As far as external growth is concerned, the relations between companies and their contexts create opportunities for greater competitive advantages, as well as for increases in size. Business combinations are a means for the external growth. Since companies are not self-sufficient, they might have to obtain resources and skills from partners in the form of business combination. Both formal and informal deals are used in the luxury business. In particular, strategic alliances are frequently resorted to as a form of formal business combination, and subcontracting is widely used as a form of informal business combination. In both cases, the companies involved might take advantage of their partners' potential without making their own manufacturing structures less flexible.

The *fifth and last chapter* deals with M&As in the luxury business and with the integration process that follows any operation of merger and acquisition. M&As are usually performed with the purpose of achieving external growth and integration is crucial to the success of any such operation. The chapter outlines the main forms of acquisition before focusing on vertical, horizontal and concentric acquisitions, which are the most frequent in the luxury business. Such large groups often pursue external growth by purchasing other companies that own strong brands. The brand is the key element of their competitive strategies and it is generated by a luxury company's communication processes and fed by interlocutors' trust in the company. In the M&As, the luxury brand can be considered as a measure of luxury: a product marked by a luxury brand is also considered a luxury product and customers' perception of a brand defines it as a luxury one. A brand becomes a sort of social indicator that "marks" both a product and its owner, allowing the owner to demonstrate a certain social position. It permits the luxury product to be distinguished from a product that, even if of good quality, is handcrafted without being luxurious. Thanks to its value, a brand generates so-called goodwill and increases the performances of the M&As.

Turin, October 2012 ELISA GIACOSA

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1
The Luxury Business

1.1 Defining the Word "Luxury"

There is no one definition of the word "luxury" and this is due to the fact that luxury is a rather personal phenomenon: each consumer sees it in their own way. Moreover, what people consider "luxury" may vary in accordance with the political, social and economic structure of a given context. The difficulty in providing *one* definition of luxury is also related to the increasing number of its manifestations: concepts such as new luxury, affordable luxury and *masstige* (that is, mass prestige) show that luxury is undergoing a slow process of democratisation, resulting in a wider range of target customers. As a consequence, some companies have been lowering the standards of exclusivity of their products and looking for profitable opportunities outside their usual market niches.

In order to formulate a definition of luxury, it may be useful to adopt three different approaches[1] (Figure 1.1):

- the personal experience approach, viewing luxury as an individual phenomenon. It is considered to be a very personal experience, in that an item may be seen as a luxury object by some individuals and as an example of bad taste by others. The concept of luxury has changed over time, turning from a phenomenon mainly related to public life into one closer to the individual. One might argue, therefore, that luxury is used to promote the image of the individual[2]. Oscar Wilde maintained that luxury is represented by objects that the individual might admittedly do without, or actually get rid of, unless the individual is sure that other people would instantly retrieve them. Wilde's definition brings into light that feeling of conceitedness that is related to owning a luxury item. Furthermore, having a luxury item arouses other people's craving for luxury and drives them to imitate the person who can afford to buy such an item;

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[1] Kapferer J.N., Bastien V., *Luxury Strategy*, FrancoAngeli, Milano, 2009, p. 60.

[2] Lipovetsky G., Roux E., *Le luxe éternel. De l'âge du sacré au temps des marques*, Gallimard, 2003, p. 59.

- the élite experience approach, viewing luxury as an élite phenomenon. In other words, viewing luxury as an experience reserved for the few people who, thanks to their wealth, can afford to spend money on both necessary and luxury items, no matter what their price is; and

- the brand extension approach, denying the specificity of luxury. This is not considered to be a category in itself. In fact, luxury may represent a border beyond which all the attributes of various kinds of goods are made extreme. In this approach, luxury is a consequence of brand extension to various categories of products, which, in terms of rarity, price, creativity, attention to detail, intrinsic quality and perception, attach a particular status to the product itself.

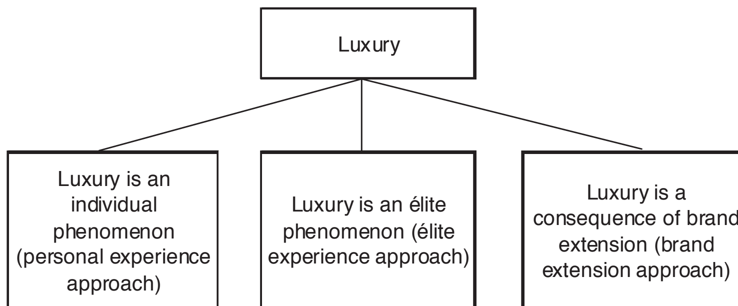

Figure 1.1 The three approaches to defining luxury

Source: Personal elaboration

Strictly speaking, a brand might be considered a "luxury brand" if it is highly exclusive as well as rare (in the sense of not being widely available on the market) and if it can identify an extremely sophisticated status symbol within its merchandise category. In this sense, as far as cars are concerned, a Rolls-Royce might be considered a luxury item, given the fact that the company has limited its worldwide target to 85,400 customers only; a piece of jewellery with an extremely rare and precious diamond may be viewed a luxury item in the jewellery industry[3]. It is this same sense of rarity that causes the CEO of Porsche to feel worried when he sees two Porsche cars of the same model parked in one street. Rarity should not be seen as a mistake in sales planning; it should be viewed as a way to make products exclusive. Ferrari imposes a limit on its yearly production, not only with the intention to regulate demand, but also to stimulate the craving for its cars. Likewise, the amount of

[3] Chevalier M., Mazzalovo G., *Luxury brand management*, Franco Angeli, Milano, 2008, p. 13 ff.

time customers have to wait to get a Kelly bag justifies its price, improves the brand status and makes people see the product as an élite item: the time customers are willing to wait is indicative of how much they crave a certain product[4].

Broadly speaking, one might consider a luxury item as a product that is not difficult to find in the market but that arouses the craving of potential customers because of the status symbol that it generates. This is the case with a number of well-known brands, such as Dom Pérignon for wines, Cartier for watches, Chanel and Louis Vuitton for bags; or Escada, Giorgio Armani and Valentino for *prêt-à-porter*.

Other definitions of luxury have been suggested by associations that operate in the market of luxury goods. According to Altagamma (an association of Italian companies that is well known abroad as operating at the top-end segment of the market), luxury is related to the first-class segment, in which businesses are characterised by innovation, quality, service, design and a prestigious brand. The French association of luxury brands, Comité Colbert, identifies luxury with a system that balances tradition and modernity, creativity and realisation, and history and innovation. The British association Walpole has listed the characteristics shared by the products supplied by luxury companies: exclusivity, creativity, innovation, quality and design.

The word “luxury” is often used as a synonym of “fashion”. Actually, these two worlds should be kept separate for the following reasons. Companies offer a wide range of products that can be defined as “fashion products” and which are targeted at different market segments, each of which is characterised by its own personality, reasons for using the product and social make-up[5]; such segments can be defined as the top-end, medium-end and bottom-end segments. The products that belong to the bottom-end segment cannot be considered luxury items because, given their price, they can be purchased by a large number of customers. Zara and H&M are two good examples: their products are undoubtedly fashion items but cannot be considered luxury items, since a huge number of people can afford to purchase them. Consequently, one might argue that “fashion” refers to both luxury products and easily accessible products. Besides, “luxury” refers to a number of merchandise categories, not just fashion items, including: cars, watches, jewellery, food, holidays, etc. Therefore, it is not accurate to identify the luxury industry with the fash-

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[4] Cefalato P., *Lusso*, Moltemi, Roma, 2003, p. 28.

[5] Bogart L., *Strategia in pubblicità. Come combinare media e messaggi con mercati e motivazione*, FrancoAngeli, Milano, 1990, p. 337.

ion industry only[6].

It is nevertheless possible to try and combine the words “fashion” and “luxury”. A product can be considered “fashionable” when it is both common and appreciated in a given context. A product can be defined as a “luxury item” when it is used to communicate a certain lifestyle and way of being: sophisticated, elegant, and responsive to style and quality. Besides, its expensive price is justified by its intrinsic qualities and functions[7]. This does not imply that a luxury product is created without bearing in mind the customer’s needs; a luxury product is just not crucially dependent on fashion trends.

Both fashion and luxury are commonly experienced phenomena in everyday life and in a number of segments: garments, bags and shoes, jewellery, watches, glasses, cars, boats, aircraft, holidays, food, interior design, etc. Fashion products and luxury items share a characteristic: manufacturing companies have to sell them successfully[8]. What is different is the kind of customers at whom their products are targeted. In conclusion, the world of luxury and the world of fashion are two different worlds that overlap in a very marginal way. They do get closer when a kind of “tandem effect”[9] takes place between the brand, which epitomises luxury, and the creativity of a designer, which typifies fashion.

1.2 Human Needs in the Luxury Products Market

Human behaviour is driven by a series of needs that the individual has to satisfy. A need is represented by the perception of a lack[10] in everyday life, which is satisfied through the availability of one or more kinds of goods. An individual tends to satisfy their needs by defining a personal system of choices, which has to do both with the needs being met and the way in which they should be satisfied.

When related to luxury, human needs are influenced by the level of cul-

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[6] Giacosa E., *L’economia delle aziende di abbigliamento*, Giappichelli, Torino, 2011, pp. 81 ff.

[7] Simmel G., “Fashion”, *The American Journal of Sociology*, 62, 1957, pp. 541 ff. Modina S., *Il business della moda*, Franco Angeli, Milano, 2004, p. 10.

[8] Pistolese R., *La moda nella storia del costume*, Cappelli, Rocca San Casciano, 1981, p. 259.

[9] Kapferer J.N., Bastien V., *Luxury Strategy*, cit., p. 54.

[10] Airoldi G., Brunetti G., Coda V., *Corso di Economia aziendale*, Il Mulino, Bologna, 2005, p. 17 ff.

tural, economic and social development of a given society. The more developed a society, the larger number of needs it creates. Human needs have become more articulated and specific, and have fuelled a vast market of luxury products that can identify a certain status.

In order to better define the kinds of needs that an individual can satisfy with luxury products, it may be useful to refer to the following classification of human needs[11] (Figure 1.2):

a) primary needs: these are defined as needs for the goods that are necessary for the individual to survive and cope with the basic circumstances of everyday life, for instance the need to drink, which is satisfied with water, or the need to eat, which is satisfied with food; and

b) secondary needs: these are related to all those needs that are satisfied through getting non-necessary goods that are beyond the basic needs of everyday life. The following needs can be classified as secondary:

- creative needs: these involve the need to have objects with which to embellish one's body. The aims are to acquire a look and to communicate something to others;
- accessory needs: these involve the need to feel trendy thanks to objects from the latest fashion collections;
- social needs: these involve the individual's need to show their belongings to a certain social group in order to show off their wealth; and
- communicative needs: these involve the need to convey a message through a material element (such as a boat) or an immaterial element (such as the brand of that same boat).

[11] Amaduzzi A., *L'azienda nel suo sistema e nell'ordine delle sue rilevazioni*, Utet, Torino, 1961, vol. I, p. 11. Kemp, S., "Perceiving Luxury and Necessity", *Journal of Economic Psychology*, 19(5), 1998, pp. 591 ff. Erner G., *Victimes de la mode?*, La Découverte, Parigi, 2004, p. 200. Giacosa E., *L'economia delle aziende di abbigliamento*, cit., pp. 13 ff.

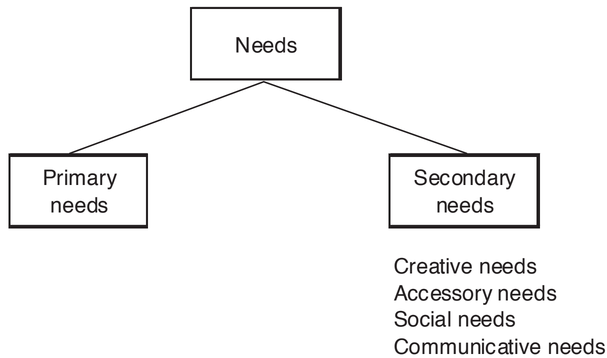

Figure 1.2 Classification of needs in the market of luxury products
Source: Personal elaboration

Each need that the individual feels influences the individual's attitude; a person's behaviour is not determined by one need only, but by a number of needs that are complementary to one another[12]. Such needs drive the individual to a certain behaviour when purchasing goods, which shows that person's cravings, priorities, perceptions and the other variables that characterise each personal choice[13]. An individual who cannot satisfy their primary needs does not feel any secondary needs. For instance, a person who hardly manages to satisfy the need to feed himself or herself and their own family does not feel the secondary communicative need to own a luxury yacht for their holidays[14]. One may consequently argue that the DNA of luxury[15] drives the individual to crave an object belonging to a higher class in their own scale of values, as soon as the needs of the previous class have been satisfied.

Luxury products are used to satisfy also secondary needs. They enable the individual to satisfy needs other than the basic needs that pertain to everyday

[12] Azzini L., *Istituzioni di economia d'azienda*, Giuffrè, Milano, 1978, p. 3.

[13] Amatulli C., Guido G., "Determinants of purchasing intention for fashion luxury goods in the Italian market: A laddering approach", *Journal of Fashion Marketing and Management*, 15(1), 2001, pp. 123 ff. Bocchino U., *L'economia delle imprese dolciarie,* Giuffrè, Milano, 1993, p. 215. Melika Husic, Muris Cicic, "Luxury consumption factors", *Journal of Fashion Marketing and Management*, 13(2), 2009, pp. 231 ff.

[14] Pavan A., *L'amministrazione economica delle aziende*, Giuffrè, Milano, 2008, p. 3 ff.

[15] Kapferer J.N., Bastien V., *Luxury Strategy*, cit., p. 37.

life[16]. The individual satisfies their need for luxury by purchasing goods that are often superfluous and unnecessary. The very fact of owning such goods shows that the individual belongs to a certain social class. This justifies paying an expensive price: its utility enables the individual to satisfy a secondary need, which is deemed rather important.

Human needs can be satisfied with "economic goods" that are available in limited quantities[17]. This forces the individual to make choices in relation to the satisfaction of their needs: first, primary needs will be satisfied. As the person's income increases, the range of needs that can be satisfied widens to include secondary needs. As far as the market of luxury products is concerned, the conspicuous financial resources of a "typical" consumer make it possible for the individual to satisfy both primary and secondary needs. The goods used to satisfy a secondary need are associated with a luxury brand that is recognised by other consumers as a status symbol and the epitome of social wealth, sophistication, and cultural and aesthetic satisfaction.

The need for luxury might be felt by an individual, who shows it by selecting among the goods available on the market those that can better satisfy that need. Alternatively, this same kind of need can be created by companies. Through aggressive marketing strategies, they inform the individual about the availability of a certain product in the range that they offer; they illustrate and praise its various functions, with the purpose of "tempting" potential customers and creating a new need[18].

A product that satisfies the need for luxury has to have a high intrinsic value representing the work made to manufacture it. The Ferrari Daytona, for instance, is presented as the perfect outcome of the knowledge and skills used in the manufacturing process, which enormously increases its value. Nevertheless, and unlike any traditional product, a luxury item is not praised for its intrinsic value, which may be defined as the use that the customer makes of it thanks to a number of its functions. It is a pointless exercise to compare a traditional product with a luxury item on the terrain of functions: both a Ferrari Daytona and a common car can move people and things from one place to another. An individual who purchases a Ferrari, however, does not justify the purchase in terms of the utility of the car. A Ferrari is chosen not because it can satisfy an everyday need, but because it opens up new possibilities: a whole new world where beauty and exclusivity are of the essence.

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[16] Ciappei C., Surchi M., *Il lusso nel dettaglio*, Firenze University Press, Firenze, 2008, p. 39 ff.

[17] Ferrero G., *Impresa e management*, Giuffré, Milano, 1987, p. 2.

[18] Giacosa E., *L'economia delle aziende di abbigliamento*, cit., p. 14.

Furthermore, a luxury product is not praised in terms of a reasonable sales price. Actually, an expensive price adds to the "glamorous feel" of the product, whereas a price that is cheaper than expected produces the opposite effect. A piece of Bulgari jewellery is seen as a luxury product not so much for the number of diamonds and their purity and carats, as for its price, which is so expensive that it makes the product itself almost inaccessible.

When satisfying a need for luxury, the individual does not compare different products because each of them in itself is considered to be the unique expression of a world of tangible and intangible attributes. A product is chosen because it is recognised as a superlative one. A company that markets such a product is not simply product-oriented; it focuses on other distinctive elements such as quality, exclusivity, style, service, rarity, post-sales assistance, etc. In addition, it positions itself in the consumer's mind[19] through the identification of the "leverage point", which may be defined as the determining factor in any purchase choice[20].

An individual's needs in terms of luxury vary in relation to the environment where they live. Any purchase is also a social action[21]: it is the result of identification with a style and it is intended to show one's belonging to a certain social group. At the same time, purchases are considerably influenced by the cultural values that make up the individual's mentality and that have an impact on the individual's behaviour, including in terms of purchase choices.

France provides a good example of this. Modern luxury was created there: well-off French people do not like to show off, preferring a kind of luxury that is recognisable by real connoisseurs, more reserved and interested in details. On the contrary, in emerging countries such as Russia, China and India[22], lux-

[19] Bucci A., *L'impresa guidata dalle idee,* Domus Academy, Milano, 1998, p. 75. Kapferer J.N., *Les marques à l'épreuve de la pratique*, Editions d'Organization, Paris, 2000, p. 104 ff. Ries A., Trout J., *Positioning: the Battle for Your Mind*, McGraw-Hill, New York, 2001, p. 2 ff. Sicard M., *Ce que marque veut dire*, Editions d'Organizations, Paris, 2002, p. 90..

[20] Lombardi M. (eds.), *Il nuovo manuale di tecniche pubblicitarie. Il senso e il valore della pubblicità*, FrancoAngeli, Milano, 1998, p. 125 ff.

[21] Scipioni D., *Net fashion. Moda, reti e tecnologie*, Cooper, Roma, 2005, p. 44.

[22] Gao L., Norton M.J.T., Zhang Z.M., Chester K.T., "Potential niche markets for luxury fashion goods in China", *Journal of Fashion Marketing and Management*, 13(4), 2009, pp. 514 ff. Kaigler-Walker K., Gilbert Z.L., "Perception of appearance and use of appearance products among Chinese women", *Journal of Fashion Marketing and Management*, 13(4), 2009, pp. 553 ff. Byoungho J., Park J.Y., Ryu J.S., "Comparison of Chinese and Indian consumers' evaluative criteria when selecting denim jeans: A conjoint analysis", *Journal of Fashion Marketing and Management*, 14(1), 2010, pp. 180 ff. Khare A., Mishra A., Parveen C., "Influence

ury has to be shown off and has to be characterised by obvious symbols. It has to demonstrate that the individual has reached a certain social status and economic wealth. Therefore, any luxury company has to segment their offer: there is no such thing as *one* kind of luxury, and luxury derives its characteristics from the environment in which the company operates. Such environments can be defined as the contexts in which cultural and social values influence lifestyle, and may represent threats or opportunities for the companies involved.

1.3 The Luxury Companies Environment

A luxury company[23] is strongly influenced by the context in which it operates.

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of collective self esteem on fashion clothing involvement among Indian women", *Journal of Fashion Marketing and Management*, 16(1), 2012, pp. 42 ff.

[23] The literature of business and management has always shown a deep interest in the concept of a "company". In order to grasp the meaning of the term "company", see the following non-comprehensive list of research approaches (we refer only to Italian studies). This note is taken from Giacosa E., Mazzoleni A., *Il progetto di risanamento dell'impresa in crisi*, Giappichelli, Torino, 2012, pp. 13 ff. Before defining the concept of a "company", it is useful to focus on the concept of an "institute" ("istituto"). This can be described as a "complex system of elements, factors and energies, as well as human and material resources", characterised by durability, dynamism and autonomy, and by the fact that it is regulated by its own rules and it is oriented to common goals (Masini C., *Lavoro e Risparmio*, Utet, Torino, 1974, p. 10). In an institute, individuals congregate in a stable and autonomous way and aim to satisfy their own needs. A company is an economic unit through which the economic activities undertaken by institutes are developed (Airoldi G., Brunetti G., Coda V., *Economia aziendale*, Il Mulino, Bologna, 1994, p. 45.). A company can also be defined as "the basic unit" of the whole economic system (Onida P., *Economia d'azienda,* Giuffré, Milano, 1971, p. 4; Zappa G., *Le produzioni nell'economia delle imprese, Vol. I,* Giuffré, Milano, 1957, p. 166). Since an institute is an aggregation of individuals characterised by durability, a company can also be defined as an economic institute characterised by durability having the purpose of lasting and aimed at producing, gaining and consuming wealth (Zappa G., *Tendenze nuove negli studi di Ragioneria,* Istituto Editoriale Scientifico, Milano, 1927, p. 30).

Other definitions of a "company" can be found in the literature. For instance, a company is also seen as the first "economic system" contributing to the universal economic system (Amaduzzi A., *Manuale di contabilità aziendale,* Utet, Torino, 1968, p. 16). The concept of a "company" has also been described as the "basic unit" of the general economic system (Giannessi E., *Le aziende di produzione originaria, Volume primo - Le aziende agricole,* Colombo Cursi Editore, Pisa, 1960, p. 46). Last but not least, others have suggested a definition of a company as "the instrument of human activity in the economy" whose goal is the satisfaction of human needs (Ferrero G., *Istituzioni di economia d'azienda,* Giuffré, Milano, 1968, p. 4).

This can be defined as "the environment" and it is made up of all that surrounds the company[24]. If one compared the environment to a living organism, the company would constitute a cell[25] with a number of dimensions, not only economic, but also social, institutional, cultural, psychological, political, natural and technological[26].

On the one hand, such an environment affects the company's activities in terms of both impediments, which limit the company's freedom[27], and opportunities, which will be analysed later. However, a company is an active subject, and as such it is not entirely limited by its context. This is due to the fact that companies can autonomously make decisions, and there would be no

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According to their business objective, companies can be classified into the following categories (see, among others, Amaduzzi A., *L'azienda nel suo sistema e nell'ordine delle sue rilevazioni,* Utet, Torino, 1953, p. 16 ff.; Ferrero G., *Istituzioni di economia d'azienda*, cit., p. 16 ff.; Onida P., *Economia d'azienda,* Giuffré, Milano, 1971, p. 5 ff.; Amaduzzi A., *Manuale di Economia aziendale,* Cacucci, Bari, 1993, p. 46 ff.):

a) a "consumption company" ("azienda di consumo"): a company that undertakes activities related to consumption and that can be defined as satisfying the needs (or a category of needs) of a specific individual or group of individuals, in a direct and lasting way;

b) a "manufacturing company" or a "company manufacturing for a target market" or a "company" ("azienda di produzione" or "impresa"): a company that undertakes a manufacturing process aimed at meeting the market demand for goods or services. A manufacturing company is a kind of company whose output is to be traded on the market in order to make a profit (Zappa G., *Le produzioni nell'economia delle imprese, Vol. I,* cit., p. 209 ff.). A luxury company undertakes a manufacturing process in order to meet a future market demand or to manufacture products after receiving an order from a customer (Ferrero G., *Istituzioni di economia d'azienda,* cit., p. 7 ff. Melis G., *Elementi di Economia Aziendale,* Giuffré, Milano, 2001, p. 7; Onida P., *Economia d'azienda*, Giuffré, Milano, 1971, p. 6 ff.); and

c) a "mixed company" ("azienda composta"): this category lies between the previous two. The manufacturing activity supports the consumption activity (Onida P., *Economia d'azienda*, Giuffré, cit., p. 11 ff.; Ferrero G., *Istituzioni di economia d'azienda,* cit., p. 18 ff.; Amaduzzi A., *L'azienda nel suo sistema e nell'ordine delle sue rilevazioni,* cit., p. 20.).

[24] This part concerning the definition and the theorical composition of the environment is taken and elaborated from Giacosa E., *L'economia delle aziende di abbigliamento*, cit., pp. 37 ff.

[25] Cricchio S., *L'impresa come momento di origine e di diffusione di fenomeni macroeconomici,* Giuffrè, Milano, 1980, p. 42.

[26] Canziani A., *La strategia aziendale*, Giuffrè, Milano, 1984, p. 24 ff.

[27] Lacchini M., *Strategia aziendale. Elementi di teoria,* Giappichelli, Torino, 1988, p. 34.

company without such autonomy[28]. On the other hand, companies can influence trends in human needs and, more generally, the habits of consumers in a given society through their impact on market needs. Such an environment is part of a broader macro-environment determined by economic, political, demographic, social and cultural factors[29].

In order to better define the influence that the environment has on luxury companies, it might be useful to limit the concept of "environment" to those factors that influence the structure and the behaviour of the company[30]. Thanks to this environment, the company exists, survives and develops[31]. Roughly speaking, the "general environment" is made up of the country or countries in which the company is located and operates. This environment restricts, stimulates and orientates company choices in a conspicuous way[32]. For instance, the general environment of LVMH Group can refer to the whole world, since the group operates in a global context. In a quite similar way, a niche company that manufactures jewellery in the district of Valenza (Italy) and operates only in Italian market cannot define its general environment in terms of national borders, since its choices are undoubtedly influenced by a global market[33].

The general environment of a luxury company may be seen as a complex "system", in that it is made up of a number of elements that are related to one another. Every part of the general environment influences the business through various inputs and impacts and might therefore be described as a sort of "circles of hell"[34] surrounding the company. They are also characterised by the dynamism and turbulence caused, among other factors, by the changeability of human needs and cravings that conditions product lines[35].

The general environment can be divided into[36]:

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[28] Ferrero G., *Le determinazioni economico-quantitative d'azienda,* Giuffré, Milano, 1967, p. 71.

[29] Coda V., *L'orientamento strategico dell'impresa,* Utet, Torino, 1988, p. 13.

[30] Brusa L., *Strutture organizzative d'impresa*, Giuffré, Milano, 1986, p. 11.

[31] Ferrero G., *Impresa e management*, cit., p. 125.

[32] Airoldi G., Brunetti G., Coda V., *Corso di Economia aziendale*, cit., p. 308.

[33] Donna G., *L'impresa competitiva. Un approccio sistemico,* Giuffrè, Milano, 1992, p. 13.

[34] Saita M., *I fondamentali dell'economia e strategia aziendale,* Giuffré, Milano, 2005, p. 21.

[35] Paolini A., *Il monitoraggio ambientale,* in Marchi L., Paolini A., Quagli A., *Strumenti di analisi gestionale*, Giappichelli, Torino, 1997, p. 103.

[36] Giacosa E., *L'economia della aziende di abbigliamento*, cit., 2011, pp. 40 ff. Mosca F., *Il marketing dei beni di lusso*, Pearson Italia, Milano, 2010, pp. 21 ff.

a) the natural environment: influences business in terms of both the resources available for the production process and the infrastructures that make business possible. In relation to this, the company makes decisions about its product portfolio and about the locations of its plants. For instance, businesses may decide to outsource to Asian markets because of the availability of labour at a low price. Moreover, other geographical data may also influence the company's business in terms of the size of the country in which the company operates, as well as its climate and the available means of communication. The demographic trends in given geographical areas may impact on the luxury business: an increase in the population, the level of urbanisation or the level of migration may influence the demand and supply.

Companies influence the natural environment through their non-compliance with norms and regulations about the environment and the use of natural resources, or through the modification of the demographic make-up of an area in terms of urbanisation and migration (such as the urbanisation caused when a large plant is built in China);

b) the cultural environment: influences the behaviour of an individual or groups of individuals in terms of ideology and values. It impacts on business through the consumption of the population. Specifically, the demand for luxury goods is determined by various factors, such as education, cultural background, religion, lifestyle, family structure, women's role in society, the level of attention devoted to children and the level of wealth at an adult age. In the last few decades, changing demographic trends together with increasing wealth have influenced the cultural aspects of the context in two ways: first, consumers of luxury products have become more and more knowledgeable and selective; secondly, a unifying trend in terms of consumption habits has emerged, regardless of the geographical area, thus encouraging the creation of brands that have global value. In both cases, consumption has ultimately changed. For instance, customers who get satisfaction from the brand Hermès tend to be loyal to the Kelly bag, not considering the geographical area it comes from and thus seeing Hermès as a global brand.

The cultural make-up of the environment makes it possible to segment the global market into categories of consumption that impact on business opportunities and consequently on company strategies. This includes: the ripe market (i.e. Western Europe, Japan and the United States) and the emerging market (i.e. Africa and other countries). The characteristics associated with the different consumers in these two markets are diverse and this influences their

consumption expenditures[37].

For instance:

- in the Russian market, conspicuous financial resources are available to the consumers of luxury products, who use them to purchase luxury products such as clothes, jewellery, watches, holidays, etc. The tastes of such consumers are not comparable to those of Western consumers in terms of refinement, in that Russian consumers prefer flashy products with which they can show off their wealth and whose expensive prices identify the products as luxury items. Russian consumers have been defined as conspicuous consumers[38], since they shop for luxury products in order to impress others and show off their own social and economic wealth[39]. The Russian market is considered extremely interesting by luxury companies; and

- the potential of the Chinese market is rather appealing: as it is densely populated, it has been witnessing the rise of the "new rich". The globalising trend is also driving a certain group of consumers to perceive Western fashion as highly exclusive. Chinese society, which is rigidly divided into various classes, has been experiencing the rise of a wealthy middle class that is attracted to the consumption of luxury goods just as much as the class of the new super-rich. Moreover, the potential related to the lower average age of the population is an opportunity luxury companies could take advantage of in the long term. In addition, the vast majority of the population lives in metropolitan areas, which are the most interesting places for businesses looking for opportunities to open new stores. This makes the manifestations of the consumption of luxury products more usable[40].

In turn, companies may influence their environment both by respecting the values of a community and by performing their social functions[41]. A company

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[37] Hall E.T., Hall M.R., *Understanding Cultural Differences,* Intercultural Press, Yarmouth, Maine, Usa, 1990. Hoecklin L., *Managing Cultural Differences: Strategies for Competitive Advantage,* 2nd edition, Addison-Wesley Publishers, Wokingham, 1996. Harrisson L., Huntington S., *Culture Matters: How values shape human progress,* Basic Books, New York, 2000.

[38] Leibenstein H., "Bandwagon, Snob and Veblen Effects in the Theory of Consumers' Demand", *The Quarterly Journal of Economics*, 64(2), 1950, pp. 183 ff.

[39] Pilyaev F.P., *Luxury in Russia through centuries*, EXMO Press, Moscow, 2000. Skrinnikov I.M., *Russians and Luxury,* EXMO Press, Moscow, 1997.

[40] Corbellini E., Saviolo S., *Managing Fashion and Luxury Companies*, Etas, Milano, 2009, p. 85 ff. Chevalier M., Lu P., *Luxury China*. *Market opportunities and potential*, John Wiley & Sons, Singapore, 2010, pp. 2 ff.

[41] Giaccari F., *Obiettivi istituzionali d'impresa e comportamenti etico-sociali*, Rivista Economica, Azienda e Sviluppo, 0, Cacucci, Bari, 2003, pp. 29 ff.

that is interested in fashion trends coming from the street has to develop its own product system – one that is the closest possible to the consumers' needs. At the same time, the business outputs are related to the influence that the company might have on fashion trends, thanks to the appeal of the brand and the company's creativity. Therefore, companies can be considered "converters of culture": they acquire signals and trends from the market and then release new fashion and consumption trends[42];

c) the technological environment: plays an important role in the consumption of luxury goods, especially those whose intrinsic characteristics are to meet certain standards of performance. Furthermore, the technological factor is also present in the ways in which consumption takes place, such as the use of websites by luxury companies[43] or in the implementation of so-called temporary stores[44]. This factor has been favoured as it widens the range of customers, reaching users keen on technology such as the young (e.g. the creation of designer mobile phones) and women (among the dedicated products are electronic devices characterised by highly fashionable design).

The technological environment generates inputs that stimulate both the creative and the production process within the creation of new products or processes, or within the improvement of existing ones. The industry of watches provides a good example: the technological factor is of the essence, especially for young customers and for Asian consumers, who are noticeably keen on technology. Technology qualifies both the product and the person

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[42] Catturi G., *L'azienda universale*, Cedam, Padova, 2003, p. 94. Bruni G., *L'azienda come sistema convertitore di valori economici in valori culturali*, in AA.VV., Atti del XXI Convegno annuale Accademia italiana di Economia Aziendale, "La gestione e la valorizzazione dei beni artistici e culturali nella prospettiva aziendale", Aidea, Siena 30-31 October 1998, p. 6 ff. Dubois B., Duquesne, P., "The Market for Luxury Goods: Income versus Culture", *European Journal of Marketing*, 21(1), 1993, pp. 35 ff.

[43] Park M., Lennon S.J., "Brand name and promotion in online shopping contexts", *Journal of Fashion Marketing and Management*, 13(2), 2009, pp. 149 ff. Yang K., Young A.P., "The effects of customized site features on internet apparel shopping", *Journal of Fashion Marketing and Management*, 13(1), 2009, pp. 128 ff. Okonkwo U., *Luxury Online*, Palgrave MacMillan, New York, 2010, pp. 11 ff. Okonkwo U., *Luxury Fashion Branding*, Palgrave, Macmillan, New York, 2007, p. 178 ff. Kwon W.S., Noh M., "The influence of prior experience and age on mature consumers' perceptions and intentions of internet apparel shopping", *Journal of Fashion Marketing and Management*, 14(3), 2010, pp. 335 ff. Kim H., Lennon S.J., "E-atmosphere, emotional, cognitive, and behavioral responses", *Journal of Fashion Marketing and Management*, 14(3), 2010, pp. 412 ff. Ornati M. (eds.), *Oltre il CRM*, FrancoAngeli, Milano, 2011, pp. 96 ff. Macchi J., *Lusso 2.0*, Lupetti, Milano, 2011, p. 19 ff.

[44] Surchi M., "The temporary store: a new marketing tool for fashion brands", *Journal of Fashion Marketing and Management*, 15(2), 2011, pp. 257 ff.

who owns it, in that it makes that individual a connoisseur in the eye of others. This is the case with the state-of-the-art mechanisms used for Vacheron Constantin and Patek Philippe watches. Also, other industries are highly influenced by inputs related to technology: consider a car manufacturing company that, thanks to the technologies available on the market, sets up an R&D taskforce and creates an innovative high-technology product. Furthermore, technology is used in the communication process in order to bring the brand closer to consumers, as well as to exploit the potential related to the internet. For instance, BMW has created short films to promote some of its cars on the internet; Prada has launched an online video to promote one if its perfumes.

The technological input enables companies to maintain their competitive advantage in the market, thanks to processes characterised by higher technological flexibility. Moreover, policies based on technological progress and innovation make benefits higher than costs[45]: the expenses met in the initial stage of any investment into innovation (such as the cost of quality in an innovation process[46]) lead to a decrease in average production costs[47]. Consequently, the know-how created within the R&D function[48] is an essential element in terms of the innovation of the products offered, which determines the development of any business[49].

On the contrary, when a company lacks know-how, it lacks innovation[50] and puts its own existence[51] at risk. In spite of the risks involved in R&D activities and in the pursuit of innovation (risks that are also due to the intangibility of the results, as well as the difficult quantification of returns on invest-

[45] Lipari C., *Alcune annotazioni sulla categoria e sulla funzione "creatività" nei sistemi aziendali*, in AA.VV., *Creatività e sviluppo dell'impresa,* Giuffrè, Milano, 1991, p. 231. Devecchi C., *I costi di ricerca e sviluppo*, Giuffrè, Milano, 1979.

[46] Saita M., *I costi di qualità nelle imprese industriali*, Isedi, Milano, 1971, p. 83.

[47] Antonelli V., *Il costo delle strategie*, Giuffrè, Milano, 1997, p. 39.

[48] Puddu L., *La ricerca e sviluppo*, in AA.VV., *Lezioni di Economia Aziendale*, Giappichelli, Torino, 1996, p. 161 ff.

[49] Cavazzoni G. (eds.), *L'attività di ricerca e sviluppo nell'economia delle imprese: il caso dell'Umbria*, Giappichelli, Torino, 2010. Vergara C., *Su taluni aspetti di correlazione fra "creatività" e sviluppo dell'impresa*, in AA.VV., *Creatività e sviluppo dell'impresa,* Giuffrè, Milano, 1991, p. 29 ff. D'Amore M., *Le attività di ricerca e sviluppo: un'analisi economico-aziendale*, Grafica Nappa, Aversa, 1997.

[50] Riccaboni A., Busco C., Maraghini M.P (eds.), *L'innovazione in azienda: profili gestionali e cognitivi*, Cedam, Padova, 2005. Valotti G., *Economicità e innovazione nelle imprese di servizi locali*, Egea, Milano, 1994.

[51] Rullani E., "Il valore della conoscenza", *Economia e politica industriale*, 82, 1994, pp. 47-73.

ments[52]), they both contribute to the competitiveness of companies in the medium-long term. An innovative company generates know-how resulting in new products and new forms of consumption. For instance, when a car manufacturing company creates a new electric car, its output is represented not only by the product itself, but also by the potential for driving the customer towards deeper awareness of environmental problems;

d) the social environment: defined as the social structure (with stratification in groups), the relationships between the groups and the possibility of social mobility. These are at the basis of the differentiation and the identification of individuals within society[53]. The relationships that the company consistently creates and maintains with the environment result in the creation of a social body[54], in which the company finds its own foundations; that same social body has a remarkable influence on the development of the company[55]. As far as luxury is concerned, the social structure creates various forms of "sociability", which are determined by the consumer's wish to make a dream come true or to reach a certain social status[56]. Companies are influenced in terms of the allocation of tasks and power among their staff, as well as their informal organisation, which results in the formation of spontaneous groups. Moreover, business is influenced by the quality of the relationships between social classes, which impacts on the company's operational scope, and by the presence of trade unions and lobbies that may limit its choices.

Any luxury company influences its social environment in that it impacts on the social structure through the development of fashion trends. Fashion enables the individual to express their own social identity through non-verbal behaviour. Outputs generate an impact because market trends can be seen as a social fact[57], since they are related to the behaviour of individuals in society.

Consumers have various behaviours according to their own social attributes[58]. They might have a mature attitude towards luxury goods and show

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[52] Campra M., *L'economia delle aziende di software*, Giuffrè, Milano, 1994, p. 102.

[53] Minestroni L., *Comprendere il consumo. Società e cultura dai classici al postmoderno*, FrancoAngeli, Milano, 2006, p. 113.

[54] Besta F., *La Ragioneria*, Valuardi, Milano, Vol. I, 1909, p. 154 ff.

[55] Ceccherelli A., *Introduzione allo studio della ragioneria generale. Gli organismi aziendali,* Le Monnier, Firenze, 1923, p. 17 ff.

[56] Paquot T., *Elogio del lusso. Ovvero l'utilità dell'inutile*, Castelvecchi, Roma, 2007, p. 25.

[57] Segre S., *Made in Italy*, Guerini, Milano, 1999, p. 19.

[58] Cappetta-V. Perrone-A. Ponti, *Competizione economica e competizione simbolica nel fashion system,* in *Economia & Management*, n. 2, 2003.

strong loyalty to top-end products. Consumers may have an emerging behaviour when the consumption of luxury goods is occasional: purchases are rare and intensify when prices decrease. Last but not least, individuals might have a marginal attitude when luxury products have marginal or non-existent appeal to them.

When considering the behaviour of consumers, it is possible to identify various areas in the global market of luxury products on the basis of the appeal that luxury has for the individuals. Some of those areas identify a mature market, such as Western Europe, Japan and the United States. Some relate to an emerging market and are also defined as "areas of the new rich", where the appeal of luxury brands has become so strong that they now represent an important target market for companies (this is the case with Russia; the Arab Emirates; Asian countries such as China, India, Korea, Thailand and Singapore; and Argentina and Brazil in Latin America);

e) the political and legislative environment: creates inputs for businesses through the political and legislative systems. First, the political system determines a certain political atmosphere and the policies that impact on businesses as restrictions and opportunities. Elements such as the form of government, the government's stability and the activity of the public administration (thanks to which bureaucracy is reduced) should be considered. Secondly, the legislative system provides inputs that have an impact on business through the norms and regulations of corporate and labour law, competition, taxation, etc. As for luxury goods, other specific inputs might be related to the protection of "Made in" products, which companies have been advocating.

The outputs that originate from businesses depend on the influence that they are able to have on the environment, which in turn depends on their size and negotiation power; and

f) the economic environment: determined by the economic structure and by the economic conjuncture in a given period of time. Both factors impact on the trends and kinds of consumption of the population. When an area is economically mature, it is characterised by a number of wealthy customers who are loyal to luxury products and purchase them on a regular basis, with a stable consumption of luxury goods. Beside those customers, occasional consumers of luxury products (also defined as "day trippers") are attracted by luxury. Having a limited budget, they make few purchases and spend amounts of money that are higher than their level of income, thus being forced to limit their purchases of non-luxury goods. On the contrary, when an area is economically emerging, the potential for businesses is much higher. The "new rich" and the upper-middle class are more and more driven to show their wealth through brand products that are identified as luxury goods.

Companies affect the economic environment through the production of wealth and its diffusion, which takes place after the factors of production are paid off. This plays an increasingly important role, depending on the company's size and negotiation power.

Beside the general environment, the "specific environment" also plays an active role. It is made up of that context which is closer to the company and that, as such, has an impact on the business in a more direct way[59]. Therefore, the specific environment is said to be made up of social and economic groups with which the company builds systematic exchange relationships[60]. The specific environment can be determined by referring to the sector of the company, as described below.

The relations existing between a company and its environment can be illustrated with an "input-output" model"[61] (Figure 1.3), in which the company is located at the centre of the exchanges with its context. The company gets a number of inputs[62] from its environment, such as the factors of production as well as regulations and restrictions, which can represent positive or negative external forces[63]. Inputs or energies are several: raw materials, work, capital and entrepreneurship, which is needed to combine the various inputs in the production process[64]. They influence the policies of differentiation for the product-market combinations that the company implements as opposed to its competitors.

The creation of luxury products requires the use of high-quality inputs, in that the intrinsic value of the goods plays an important role in the distinction of top-end items.The company can adapt and innovate its product-market

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[59] Ferrero G., *Impresa e management*, cit., p.146.

[60] Brusa L., *Strutture organizzative d'impresa*, cit., p. 11.

[61] Rugiadini A., *Organizzazione d'impresa*, Giuffrè, Milano, 1979, p. 10. Ferrero G., *Impresa e management*, cit., p. 10. Ossola G., *L'economia delle aziende di gestione aeroportuale*, Giappichelli, Torino, 1996, p. 260. Bozzolan S., *Bilancio e valore*, McGraw-Hill, Milano, 2001, p. 15. Giacosa E., *L'economia della aziende di abbigliamento*, cit., pp. 51 ff.

[62] In addition to the inputs derived from outside, the company is also affected by individual variables concerning the personality, skills and competences of its management. Giunta F., *La creazione di nuove imprese,* Cedam, Padova, 1993, p. 49 ff.

[63] Di Stefano G., *La composizione delle forze interne ed esterne*, in Marchi L. (eds.), *Introduzione all'economia aziendale*, Giappichelli, Torino, 1998, p. 426.

[64] Catturi G., *Lezioni di economia aziendale,* Cedam, Padova, vol. I, 1984, p. 225.

combinations in order to achieve a more significant competitive advantage[65]. In the market of luxury products, the presence of strong competitors (both leading and niche companies) forces each company to clearly differentiate its products while preserving its brand identity.

Beside the factors of production, the impact of the context may also be considered as an input, and it can result in opportunities or restrictions[66]; the former have a positive impact on business, in that they bring a number of advantages (for instance, the ongoing globalising process produces an increase in the number of customers of luxury products worldwide)[67]. The latter, on the contrary, are detrimental because they limit the company's freedom of choice (this is the case with the limits imposed on the number of products that can be imported from Asian markets). The market of luxury products is characterised by the presence of various restrictions: legislation, environmental regulations, cultural norms, etc.

Inputs are brought into a transformation process[68] that is both physical and economic, as a result of which the conditions of the utility of the factors of production used varies[69]. When the transformation process is completed, the company diffuses a number of outputs into the environment: products that have acquired a new utility[70] and that are traded in return for money[71]; and the company's impact on the environment. For instance, a company that manufactures luxury jewellery not only launches a range of products onto the market but might also influence fashion trends, thanks to the impact that their collections have on the consumers' perception.

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[65] Cricchio S., *L'impresa come momento di origine e di diffusione di fenomeni macroeconomici*, cit., p. 34.

[66] Corticelli R., *La crescita dell'azienda: armonie e disarmonie di gestione*, Giuffrè, Milano, 1979, p. 30. Ferrero G., *Impresa e management*, cit., p. 127.

[67] Sciarelli S., *Il sistema d'impresa: strategie, politiche e tecniche di gestione dell'impresa industriale,* Cedam, Padova, 1991, p. 229.

[68] Airoldi G., Brunetti G., Coda V., *Corso di Economia aziendale*, cit., p. 21.

[69] Lattanzi N., *Fenomeno aziendale e dinamica ambientale,* in Anselmi L., Lattanzi N., *Elementi di management e dinamica aziendale*, Giappichelli, Torino, 2002, p. 36.

[70] Farneti G., *Economia d'Azienda*, Franco Angeli, Milano, 2007, p. 2. Melis G., *Elementi di Economia Aziendale,* cit., p. 5.

[71] Andrei P., *Note introduttive allo studio dell'economia delle aziende di credito*, in Andrei P., Azzali S., Tanzi A. (eds.), *Saggi vari di Economia Aziendale*, Giappichelli, Torino, 1991, p. 113.

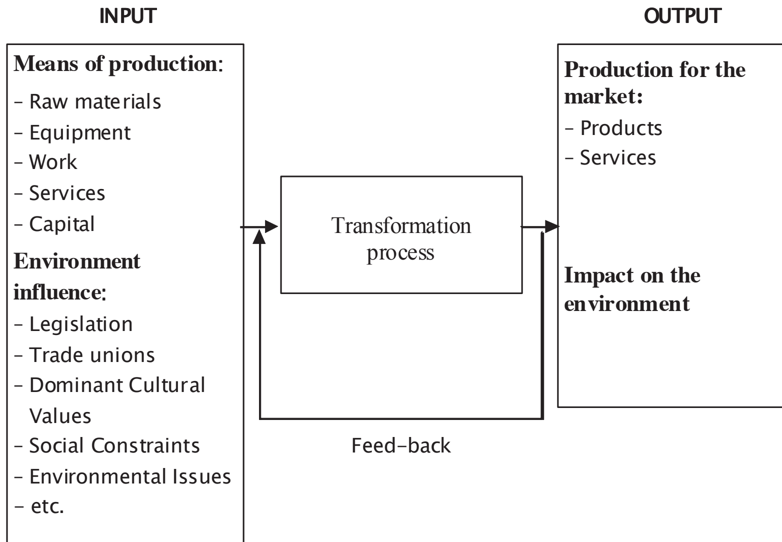

Figure 1.3 The "input-output" model

Source: Ferrero G., Impresa e management, cit., p. 10

1.4. The Luxury Products Sectors and Markets

In order to define the operational context of companies whose business is focused on luxury products, it might be useful to describe the concepts of a "sector" and a "market"[72] and to apply them to the context of luxury.

A "sector" is made up of a number of companies that share one or more of the following criteria: the process of acquiring the factors of production; the process of manufacturing goods and services; and the process of distributing goods and services[73]. When different analysis objectives as well as various classification criteria are considered, a company might be part of different sectors. A sector is also defined as a group of companies characterised by similar economic activities, which operate in the same markets and have the same demand-and-supply structure[74].

[72] Giacosa E., *L'economia delle aziende di abbigliamento*, cit., pp. 64 ff.

[73] Ferrero G., *Impresa e management*, cit., p. 46.

[74] Airoldi G., Brunetti G., Coda V., *Corso di Economia aziendale*, cit., p. 309.

Unlike other industries, there is no such thing as one sector of luxury products. This is due to the fact that luxury extends to more than one sector. Nonetheless, all luxury products are social markers, in that they share the function of emphasising the individual's wealth or their belonging to a certain social class.

The sectors involved with luxury can be classified according to how traditional they are in terms of supplying luxury products. In particular, the following categories of sectors might be identified[75] (Figure 1.4):

1) core luxury sectors: traditionally associated with luxury, these include:

a) apparel: this sector contributes to luxury both with haute couture and top-end *prêt-à-porter* for men and women (e.g. brands such as Escada, Louis Vuitton, Valentino, Giorgio Armani, Versace, Chanel and Dior); and with other brands that, although selective in their distribution policies, have less expensive prices (such as Prada and Gucci). *Prêt-à-porter* in particular has been repositioned in a more exclusive way in terms of price and offer, which is also thanks to first-rate tailoring.

Lying between haute couture and *prêt-à-porter* is the so-called demi-couture. Hand-crafted garments are targeted at the top-end segment since they guarantee shorter try-on and waiting times. Characterised by great creativity as well as high-quality tailoring, they are marketed at a much lower price than haute couture (up to ten times less expensive); the availability of items is limited, which makes them rare and exclusive (often, only one item is available in each boutique). Riccardo Tisci for Givenchy, or Stefano Pilati when he worked for Yves Saint Laurent, and Oscar de la Renta are good examples.

Such segments are characterised by highly creative ranges of products, in spite of the fact that in the last few years their turnover has not had the same increasing trend as accessories. In order to differentiate themselves from affordable luxury, *prêt-à-porter* companies have increased their prices. Brands that operate in bottom-end segments do not belong to the sector of luxury: they do not implement selective distribution policies and are characterised by lower prices, as well as poorer quality (such as Zara and H&M);

b) accessories: the offering of this sector includes items other than garments that, being related to clothes, are used to adorn oneself and differentiate the individual's look in a very similar way. Some examples are bags and other

[75] Mosca F., *Il marketing dei beni di lusso*, cit., pp. 7 ff. Chevalier M., Mazzalovo G., *Luxury brand management*, cit., p. 14 ff. Giacosa E., *L'economia della aziende di abbigliamento*, Giappichelli, Torino, 2011, pp. 84 ff. Corbellini E., Saviolo S., *Managing Fashion and Luxury Companies*, cit., p. 23 ff. Corbellini E., Saviolo S., *L'esperienza del lusso*, Etas, Milano, 2007, pp. 20 ff.

accessories by Louis Vuitton, Chanel, Dior and Hermès. This sector has undergone some changes over time: at first, accessories represented the first purchase by customers who approached a certain brand for the first time; the sector then became segmented in order to offer very expensive, limited-edition products alongside more easily accessible items. This caused an increase of accessories turnover on the total turnover of luxury companies. Such products are bags and other leather accessories, shoes, belts, eyewear, ties, lighters, pens, etc. Thanks to their "fashion touch", accessories are no longer considered only complementary to an individual's look: they have become trendy items. This sector is densely concentrated around international brands, such as LVMH, Gucci, Richemont and Hermès;

c) jewellery and watches: this sector includes companies that manufacture and/or market jewellery and watches with high intrinsic value through carefully selected stores. It is a densely concentrated segment, characterised by the presence of historic brands such as Richemont, which owns Cartier, Rolex, Tiffany and Bulgari. This sector also includes businesses offering products that are more easily accessible and related to fashionable luxury design brands. This segment went through a period of crisis in the early 2000s, but the situation has improved thanks to the recovery of consumption in emerging markets; and

d) perfumes and cosmetics: a part of the range of products might be defined as highly exclusive when considering brands traditionally associated with luxury. Prices are very expensive and distribution policies are carefully selected (e.g., facial creams by Carita Paris, whose price makes them accessible to a limited group of customers, or creams and serums by La Prairie, which are prepared with caviar).

Products whose price is slightly less expensive might also be included. They are targeted at a new group of customers whom companies wish to loyalty. Such customers are reached through policies of brand extension. Contracts of licence have been used in order to reach this goal. This also leads to the global diffusion of brands, thanks to a strong presence throughout the world. The sales derived from licences in perfumes and cosmetics account for a considerable part of the total turnover of luxury companies. Licences might be seen as a way to diffuse brand values. In other instances, it enables a brand to be qualified in contexts that are different from the one typically associated with their main product: this is the case with Ferrari clothes, watches, pens, lighters, carryalls, etc., which might be used on occasions other than a car journey. This segment holds huge potential for companies. For Harley Davidson, for instance, the business derived from licensed products represents about one third of their profits; and

2) emerging luxury sectors: not traditionally associated with luxury, these have led to a widening in the range of luxury products in the last few decades. They include the following:

a) wines, spirits and food: food and wine consumption represent the new age of luxury, thanks to the combination of customisation and rarity that typically characterises other merchandise categories. Products are marketed in specialised stores: their expensive prices attract a highly selective group of customers. Since they are showcased as works of art, such products are also described as commodity chic. This category also includes wines and spirits that, despite being sold in non-selective stores (such as supermarkets), are characterised by expensive prices. Therefore, not only the choice of distribution channels but also price play an important role in defining the status of a luxury product.

Also, the food sector offers a range of luxury products marketed in highly exclusive stores. Customers, or connoisseurs, have deep knowledge of sophisticated products and are attracted by the experience of luxury associated with enjoying them. Extra care in eating habits[76] is focused on the concept of organic, traditional, local food that contains little fat, salt and sugar. Single-serving meals tend to be favoured as healthier, alongside functional ones that are more user-friendly to people who lead a busy modern life. Food should not be heavily manipulated and should preserve its original quality components in order to be truly symbolic of a territory and its unique values. Brands are usually not globally known: they are niche brands targeted at connoisseurs; in some instances, the brand is internationally known but has limited sales volumes (the champagnes Roederer Cristal or Dom Pérignon might be good examples). Commodity chic is apt to satisfy the senses: taste, thanks to the use of the best ingredients; sight, through the use of sophisticated materials and colours for packaging; smell, stimulated by the aroma of freshly made products; and hearing, when biting into the product;

b) cars: the luxury segment of the automotive sector is oriented towards the manufacturing and marketing of top-quality brands characterised by exclusive positioning and distribution, as well as expensive prices (in different level), such as Rolls-Royce, Ferrari, Mercedes, BMW, Audi, Bentley, Maserati and Porsche;

c) restaurants and tourism: touristic products have increasingly been targeted at the top-end segment of the market. High levels of quality and creativity have been applied to a wide range of products, including luxury hotels,

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[76] Gandini C., Turinetto M., *Lusso necessario alla ricerca del valore per vincere la crisi*, Lupetti, Milano, 2009, p. 45.

first-class comfort flights, cruises and private yachts. The segmentation of the offer involves products of both affordable and non-affordable luxury. The former features remarkable products such as those by Azimut-Benetti Group and Ferretti Group, which manufacture extremely expensive private luxury yachts. As for luxury hotels, Armani, Versace, Ferragamo and Bulgari are good examples. Bulgari Hotels & Resorts has opened three luxury hotels around the world: one in Milan in 2004, one in Bali in 2006 and one in London in June 2012. The next hotel will be opened in Shanghai in 2015, in partnership with OCT, the leader in the Chinese tourism industry. Also, aircraft have been devoted some attention by the best-known designers: for instance, Versace has created a partnership with Tag Group, the leader in the manufacturing of private jets, extending its brand to a highly exclusive context;

d) the arts and cultural goods and services: changing consumption trends together with higher social wealth have led to a widening of the offer in sectors related to culture. Companies aim at both attracting new customers and consolidating their relationships with loyal ones through the creation of special occasions during which the latter can enjoy the brand in a very exclusive way; and

e) furniture and home decoration: a number of companies, such as Versace, Armani, Blumarine and Fendi, have enlarged their range of products by creating collections of furniture and ornaments characterised by the creative approach typically associated with their brands.

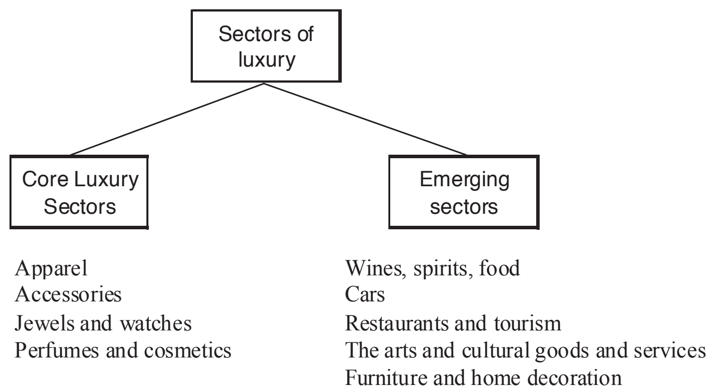

Figure 1.4 The sectors of luxury

Source: Personal elaboration

Having defined the sectors related to luxury products, it might be useful to describe their "specific market"; that is, the context in which the company acquires the factors of production and sells its products. A market may be defined with two different approaches. First, with reference to transactions, a market is the place – either physical or virtual – where the demand and the supply meet. Instances of this are boutiques, stores, outlets, showrooms and websites[77]. Secondly, a market can be defined with reference to the relations that the economic actors establish through a given price system[78]. Such actors are the manufacturing company, suppliers, distributors, middlemen, final customers, etc. In the context of their own market, companies establish relationships with other subjects before (especially with suppliers) and after (with distributors, middlemen, wholesalers, store owners and final customers) the manufacturing process.

Crucially, markets are the places where companies acquire the factors of production that they need and subsequently sell their products. A market can be described as an arena where competitors face one another and consequently influence business choices: each and every market change impacts on the companies that are part of it[79]. Any strategic move of any competitor that might cause one or more characteristics of the competitor itself to change in terms of product quality, price, costs of the means of production, payment conditions, etc. considerably influences the other companies.

In order to define the market segments at which luxury products are targeted, it might be useful to describe the market structure as a system of segments from largest to smallest[80]:

- the bottom-end or mass segment: related to basic products that are characterised by very few style markers and low prices. They are therefore widely and easily available[81]. Such products are used in everyday life, both at work

[77] As for the different types of market, please refer to Rechenmann J., *Internet e marketing*, Editions d'Organisation, Paris, 1999. Ries A., Ries L., *The 11 immutable laws of internet branding*, HarperCollins Business, London, 2000. Levy M., Weitz B.A., 2006, *Retailing Management*, McGraw-Hill/Irwin, New York, 2006.

[78] Bastia P., *Principi di economia aziendale,* Cedam, Padova, 2009, p. 169.

[79] Campedelli B., *Analisi aziendale: strumenti concettuali, metodologici e di valutazione dell'impresa*, Giappichelli, Torino, 1998, pp. 63 ff.

[80] Terzani S., *Controllo di gestione nelle imprese di alta moda*, Franco Angeli, Milano, 2007, p. 9 ff. Giacosa E., *L'economia delle aziende di abbigliamento*, cit., p. 67.

[81] Okonkwo U., *Luxury Fashion Branding*, cit., p. 130 ff.

and for leisure;

- the medium-end segment: products are moderately creative and a large number of customers can afford them. People who purchase such products are not interested in their exclusivity: they just want to feel trendy;

- the upper medium-end segment: related to products targeted at a limited number of people who are interested in quality and willing to pay an expensive price, which is justified by the high levels of quality and innovation of the product itself. This segment includes part of the range of luxury products; and

- the top-end segment: products are characterised by first-class quality, creativity and sophistication; prices are so expensive that very few people can afford them[82]. Non-affordable luxury products are related to this segment.

The luxury market can be described as a group of smaller niche markets. When considered as a whole, these create a large turnover and attract a considerable number of customers. For instance, Godiva, the leader in the market of luxury chocolate, has a small market share in each country; when such shares are considered together, Godiva's leadership on a global scale is evident[83].

The market of luxury products might be seen as an arena of competitors where companies operating in different sectors compete with one another, since they target the same category of consumers[84]. This is due to the fact that potential customers, regardless of merchandise categories, are attracted by the symbolic value of a brand. This creates competition for different objects, resulting in competition among companies.

In the last ten years, the luxury market has changed so considerably that a genetic modification of companies has followed[85]: companies have been redefining some of their characteristics, as well as some of their relations within the context, where businesses of various sizes operate (large groups, medium-sized companies and niche businesses). Large groups such as LVMH, PPR, Richemont, Hermès and Chanel are characterised by easily recognisable first-class brands and operate in various sectors with a policy of margins. They are usually global leaders in their relevant businesses and have created the so-

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[82] Dubois B., Duquesne P., "The market for luxury goods: income versus culture", cit., pp. 35-44. Kapferer J.N. *The new strategic brand management*, Kogan Page, London, 2004. Bruce M., Hines T., *Fashion Marketing*. *Contemporary Issues*, Elsevier Ltd, Riverport, 2007.

[83] Giacosa E., *L'economia della aziende di abbigliamento*, cit., pp. 85 ff.

[84] Mosca F., *Marketing dei beni di lusso*, cit., 4 ff.

[85] Campedelli B., *Analisi aziendale: strumenti concettuali, metodologici e di valutazione dell'impresa*, cit., p. 5.

called "luxury conglomerates", thanks to their brands[86].

Generally speaking, luxury companies are characterised by high profitability; some of them are leader players in a global market, taking the approach of producing high product volumes and obtaining economies of scale, which is the case with PPR, LVMH and Prada. By contrast, niche companies operate with low volumes and have considerable profitability thanks to their high specialisation (like Ferrari).

[86] Kapferer J.N., *The new strategic brand management*, Kogan Page, Londra, 2004, p. 69.

2
Luxury Product Management

2.1 Luxury Typologies

Considering the luxury phenomenon, strictly speaking, the reference target is represented by an élite group of extra rich[1]: ideal customers are those individuals who have wealth to employ in luxury product purchases. In a wider sense, luxury is considered a more democratic phenomenon that is becoming a prerogative of a less restricted range of people. Luxury companies draw growth potential from it increasing their customers.

The following pyramid represents the offer segmentation, showing three different luxury levels[2] (Figure 2.1):

a) non-affordable luxury;
b) intermediate luxury; and
c) affordable luxury.

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[1] Dubois B., Duquesne P., "The market for luxury goods: income versus culture", *European Journal of Marketing*, 27(1), 1993, pp. 35 ff.

[2] Okonkwo U., *Luxury Fashion Branding*, Palgrave, Macmillan, New York, 2007, p. 237 ff. Chevalier M., Mazzalovo G., *Luxury brand management*, Franco Angeli, Milano, 2008, p. 16. Giacosa E., *L'economia della aziende di abbigliamento*, cit., pp. 91 ff.

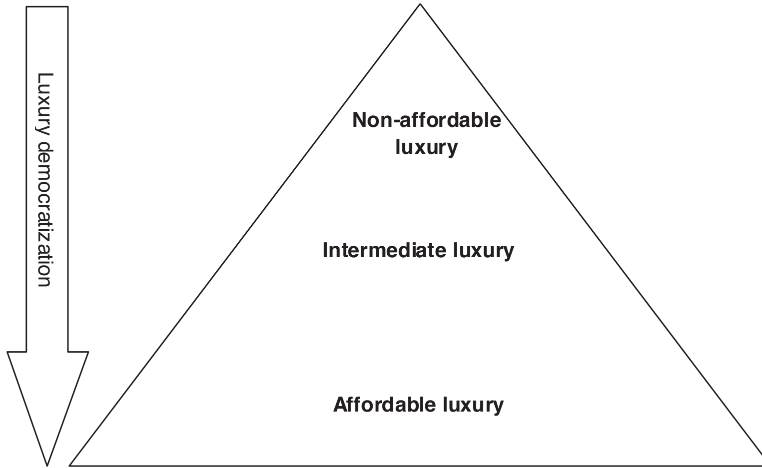

Figure 2.1 Luxury typologies

Source: Personal elaboration

Brands corresponding to various luxury levels belong to different merchandise categories: precious Bulgari jewellery, Ferrari Daytona cars, Hermès Kelly bags and Ferretti super-luxury yachts are good examples of non-affordable luxury products presenting different features. Moreover, a brand can be matched with more than one luxury level: the Bulgari brand is employed both at the non-affordable luxury level, which represents the company's core business, and at the affordable one with less expensive products, such as industrially produced perfumes and jewellery made of less exclusive raw materials.

2.1.1 Non-affordable Luxury

Non-affordable luxury (also called extra-luxury) represents highly exclusive luxury products, which are difficult to afford due to their high prices, with highly exclusive distribution and scarce availability justified by the time and manual ability required for production. They are produced in limited editions or often as single pieces, with strong customised, handcrafted or semi-handcrafted elements representing important company heritage.

The rareness of the product avoids its value dilution, maintaining its potential in the minds of the élites who can afford it. Non-affordable luxury can be

compared to a "Luxury Island"[3] that can only be conquered by privileged individuals.

The rareness concept has more than one meaning and it has to be interpreted. Strictly speaking, absolute rareness reflects non-affordable luxury. It represents rareness since it refers to the small number of product pieces available on the market; Ferrari is an example. From a wider point of view, rareness is virtual: it is a social limiter and does not refer to the available quantity. La Prairie caviar essence skin creams do not have selective distribution and limited editions. Nevertheless, their prices make them differ from other lines of cosmetics so are considered luxury products even though they are not rare.

The intrinsic features of a product do not often carry functional benefits compared to common goods (a Kelly bag contains objects just as well as a Zara model); the status symbol derived from owning the product makes the difference.

Defining the reference target follows the potential customers' wealth level criterion, since only those with great wealth can afford highly expensive products. This does not mean that a very rich individual likes Ferrari cars or Chanel haute couture dresses; wealth makes the individual inclined to buy top luxury products. Moreover, the non-possession of a great wealth directly excludes the possibility of approaching the non-affordable luxury sphere. The number of super-riches belonging to this target group is constantly increasing, due to the growth of an elitist class in emergent countries.

Non-affordable luxury products are meant for a target group made up of a restricted range of people worldwide: the so-called HNWIs (high net worth individuals), whose wealth is equal or superior to a million dollars (main residence excluded), with substantial wealth to undertake irrational purchases. They own the so-called *argent de poche* (pocket money)[4]. Therefore, non-affordable luxury is non-democratic; that is, it does not have a great number of customers.

As a result of the limited reference target, companies aim to employ a margin policy with high profits deriving from the selling of each single piece, without strong sales volumes. Seventy bicycles with diamonds, Swarovski jewelled pianos with 30,000 hand-set crystals and Ferrari Testarossa motor in a boat are examples of non-affordable luxury products.

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[3] Kapferer J.N., Bastien V., *Luxury Strategy*, FrancoAngeli, Milano, 2009, p. 27.

[4] Tartaglia A., Marinozzi G., *Il lusso … magia e marketing*, Franco Angeli, Milano, 2006, p. 63.

2.1.2 Intermediate Luxury

Intermediate luxury (also defined as luxury) includes non-customised, mass-produced or limited-edition products, with quality and style, with an easily recognisable brand, commercialised through selective channels. The product often derives from an expensive reproduction of individual and unique products belonging to non-affordable luxury.

The contemporary luxury products of big luxury companies whose production is spreading towards a wider range of customers represent an example. Bottega Veneta produces limited-edition articles (with 50 pieces at most) that are commercialised worldwide: the aim is to satisfy sophisticated customers looking for customisation and exclusiveness.

2.1.3 Affordable Luxury

Affordable luxury represents the expansion of luxury historical brands towards a wider range of customers by offering more affordable product ranges, such as accessories, glasses, perfumes and cosmetics, often inspired by non-affordable luxury[5]. Keeping the Luxury Island analogy for non-affordable luxury, affordable luxury connects the country of consumers with Luxury Island, which becomes more available. Nevertheless, some brands seem to not be involved in the trading-down phenomenon, such as Hermès and Chanel; Birkin, Kelly and 2.55 bags are still handmade and their prices are not affordable for most consumers.

Generally, products have satisfactory quality with high style content and have more affordable prices. Famous griffes joung lines add up to them. Companies aim to develop product visibility thanks to the products' quality and aim to develop an aggressive commercial policy that gives the brand (and consequently the product) a strong image. The purpose is to offer a dream at a more affordable price.

Affordable luxury is the origin of the "new luxury" or "neo-luxury" phenomenon[6]: customers who generally cannot afford a luxury product allow themselves to buy one during sales or particular promotions, as in a sort of treasure hunt[7]. This provides an opportunity for companies since they can

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[5] Silverstein M.J., *Caccia al tesoro,* Etas, Milano, 2006, pp. XIII ff. Corbellini E., Saviolo S., *Managing Fashion and Luxury Companies*, Etas, Milano, 2009, pp. 53 ff.

[6] Giacosa E., *L'economia della aziende di abbigliamento*, cit., pp. 92 ff.

[7] Cappellari R., *Il marketing della moda e del lusso*, Carocci Editore, Roma, 2008, p. 18. Tartaglia A., Marinozzi G., *Il lusso … magia e marketing*, cit., p. 55.

increase their number of target customers and their turnover. The affordable luxury segment, which is so widespread in Western countries, is also called "luxury rich, asset poor", referring to the middle class with small wealth that are attracted by luxury consumption.

Luxury democratisation occurs through the "trading-up" phenomenon[8]: customers sort of "zap"[9] between luxury products and the more traditional ones because they are not wealthy enough to afford all that they desire. So, they make a choice in a scale of desires where products belonging to different merchandise categories are placed: the individual is obliged to choose between a holiday and a designer watch, a bag or a weekend in a spa. Products, even those belonging to different merchandise categories, are put in competition, since individuals reveal the need to own a luxury product without lingering so much on its intrinsic features.

Luxury democratisation sees its reference target spreading with "day trippers", i.e. occasional luxury customers opt for more affordable articles such as perfumes, accessories and designer glasses. Their accessible prices make the customer feel the atmosphere of a valuable brand, even though they do not own haute couture expensive garments by that stylist. "Early adopter" are included in the day tripper category: they purchase luxury products only when they represent a consumption novelty. Their scouting among new styles, trends and technologies makes them only choose highly innovative products.

Affordable luxury derives from abandoning exclusive rareness. Big luxury companies adopt this philosophy by commercialising more affordable products. On the one hand, the aim is to spread their brand to new luxury markets (China, Japan, Russia and South America) and increase their market share; on the other hand, the idea is to comply with a new market demand that non-affordable luxury products could not satisfy. Ferrari have doubled their production to meet the new riches demand. To avoid overexposure caused by missing product rareness, the company prefers to sell products of different merchandise categories (clothes and accessories), which reveal their belonging to the Maranello universe through the brand. Many studies have confirmed the validity of the affordable luxury category, since a predominant customer share does not meet the luxury-rareness combination[10].

Contrary to non-affordable luxury, the reference target of affordable luxury is not easy to define: it includes both individuals who usually buy luxury, non-

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[8] Silverstein M.J., *Caccia al tesoro,* cit., p. 4 ff.

[9] Gandini C., Turinetto M., *Lusso necessario alla ricerca del valore per vincere la crisi*, Lupetti, Milano, 2009, p. 26.

[10] Danziger P., *Let them eat the cake*, Kaplan Books, Dearborn, 2005.

affordable and intermediate products (also, private jet owners like Prada bags), and individuals who can afford luxury products occasionally. Consumption trends in the luxury market can therefore be represented by an overturned pyramid, where upper class tastes are various and transversal on different sectors such as fashion, tourism, restaurants, watchmaking, etc. By contrast, middle-class tastes are limited to a small occasions because they have fewer consumption possibilities and fewer past experiences[11].

Affordable luxury allows customers to integrate themselves in a luxury product society[12]; window shopping (the act of walking alongside shops, observing, inquiring and trying on goods without a real purchase need) becomes a sort of good taste and look school made of symbols representing a style universally recognised as luxurious.

Owning a luxury product represents belonging to that society and gives a social rank. The philosophy that has emerged in Japan demonstrates this social integration phenomenon: displaying the same Louis Vuitton Monogram bag model is perceived as a demonstration of having all the necessary requirements to be part of that world. Thus, affordable products become a means of brand circulation and social elevation.

The sale of an affordable luxury product generates a lower margin of profit for a company than that generated by the previous categories, but at the same time the purchase volume is higher since the reference target is wider. Nowadays, affordable luxury represents 98% of the luxury product business.

This luxury typology involves the risk of image loss for a brand caused by its strong extension. On the one hand, this kind of luxury can increase companies' turnover; on the other hand, it can provoke the image loss of a brand due to its overexposure. If HNWIs feel that a brand has become overexposed due to its accessibility for day trippers, they may no longer consider it to be an exclusive brand.

The action of establishing whether a product is an affordable luxury or non-luxury product is extremely subjective: brand indexation in a specific context can help[13]. In China, Lacoste is considered a luxury brand, since it occupies the third position in the most famous brands chart of Time magazine (2007). The brand's fame has been acquired during the Shanghai Masters tennis tournaments. On the contrary, in European countries, Lacoste is considered a

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[11] Peterson R.A., Kern R.M., *Changing highbrow taste: From snob to omnivore*, American Sociological Review, 61, 1996, pp. 900 ff.

[12] Kapferer J.N., Bastien V., *Luxury Strategy*, cit., p. 122.

[13] Ries, A., Trout, J. 2001. *Positioning: the battle for your mind*, McGraw-Hill, New York, pp. 2 ff.

non-luxury brand as the company's distribution policy favours non-restricted circulation.
A new form of affordable luxury is represented by "masstige"[14]; that is, the union of mass market and prestige business logic. It refers to a series of brands and products with peculiar features typical of high-range products, but differing in their prices and locations and thus more affordable to the wider public. This allows customers to satisfy small dreams buying products that now belong to the super-premium luxury category: dresses, cosmetics, spas, food, water, wine, liquors, high-tech products and travel goods are good examples. A customer uses masstige to combine high-style articles with mass products that acquire value thanks to the employment context. For example, Sharon Stone, at an Oscars ceremony, matched a haute couture coat and skirt with a basic Gap t-shirt. The number of non-famous people that do this is countless, as many people love to exude luxury and style. They often match different styles and brands with non-collection items, which find a place in their wardrobe near precious ones.

Another affordable luxury form is made possible by so-called "fractional ownership", involving a sort of luxury product sharing: boats, private jets, bags, watches and jewellery are examples of this new trend. The status symbol does not decrease since the customer joins other item owners aiming to belong to the same social class. Thus, points of sales renting luxury products have increased, especially for dresses and accessories. The logic to be conceived by the customer is that of a chic item loan[15].

The so-called "new senior" category refers to individuals of adult age who can afford luxury thanks to their achieved wealth. In fact, following Duesenberry's theory, improvements in living conditions and wealth lead individuals to purchase higher quality products[16]. The aging population has allowed the growth of a class of subjects who could not afford luxury goods at a younger age. In order to favour such consumption, luxury companies are employing testimonials from slightly older people (such as Demi Moore for Helena Rubinstein and Sharon Stone for Dior) to demonstrate the brand's affection towards a particular age bracket.

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[14] Nueno J.L., Quelch J.A., *The Mass Marketing of Luxury*, Business Horizons, November-December, 1998, pp. 61 ff. Corbellini E., Saviolo S., *L'esperienza del lusso*, Etas, Milano, 2007, pp. 65 ff.

[15] Michault J., *New Year's coming and no outfit? Rent it*, International Herald Tribune, gennaio 2006.

[16] Duesenberry J.S., *Reddito, risparmio e teoria del comportamento del consumatore*, Etas Kompass, Milano, 1969.

Affordable luxury has also obtained strong expansion in outlets where affordable luxury products are sold at strongly reduced prices[17]. Those customers waiting for sales seasons to enjoy luxury goods or those who only buy in outlets and never in boutiques at full price are the outlets' reference targets. This category also includes customers who like boutiques and are looking for an offer, for fun and for fashionable items, maybe with the driver and accompanied by some friends.

It is interesting to compare luxury products (distinguishing between non-affordable and affordable luxury) with non-luxury traditional goods using a series of observation criteria:

- with regards to availability, non-affordable luxury is absolutely exclusive for its rareness due to both the limited number of pieces available and the limitation of the distribution policy to selective points of sales. Affordable luxury is more accessible, while traditional goods are omnipresent and easily findable on the market;
- with regards to price, non-affordable luxury presents a very high price level, while affordable luxury is generally sold at a premium price. On the contrary, traditional goods are cheap;
- observing the quantity of available goods, non-affordable luxury has a strong limitation regarding the number of pieces put on the market, both to increase the rareness effect and because products can be handmade. Affordable luxury increases the quantity of goods sold thanks to mass handicraft production, while traditional goods are mass products; and
- observing customers' perception of buying and of product possession[18], non-affordable luxury involves the elitist desire to own unique and rare pieces, while affordable luxury is pursued by customers looking for value. By contrast, customers who buy traditional goods are driven by a sort of conformism, since they do not aim to own a unique product.

2.2 Distinguishing Variables in Luxury Product Offerings

Luxury product offerings present a series of features assigning them the status of luxury objects. Such peculiarities concern "marketing mix" variables[19], with

[17] Okonkwo U., *Luxury Fashion Branding*, cit., p. 97 ff.

[18] Vigneron F., Johnson L.W., "Measuring perceptions of brand luxury", *Journal of Brand Management*, 11(6), 2004, pp. 484 ff.

[19] Marchi L., *I processi di orientamento delle attività commerciali e vendita di prodotti/servizi*, in L. Marchi (eds.), *Introduzione all'economia aziendale,* Giappichelli, Torino, 1998,

the traditional "4Ps" directly controlled by companies:

a) product;
b) price;
c) promotion; and
d) place (distribution).

In the following paragraphs, these variables will be contextualised in the luxury market.

2.2.1 Product

A company's luxury products are a union of tangible and intangible elements[20]. The material article itself (the dress, accessory, car, private jet, piece of jewellery, etc.) is enriched by a series of attributes deriving from the item's style, design, quality and packaging. Moreover, the product reflects an attitude satisfying a whole range of expectations and desires aiming to allow oneself the best[21]. The search for status and social acceptance is among these expectations. In its more immaterial form, luxury is also represented by a new luxury sphere comprised of the post-materialistic values[22] of time, space and silence.

A product must show the individual aspects of each customer[23], since it becomes a means of communication towards society. Thus, a product reveals

p. 212 ff. Pellicelli G., *Il marketing*, Wolters Kluwer, Milano, 2005, p. 15. About marketing mix, please also refer to Borden N.H., "The Concept of the Marketing Mix", *Journal of Advertising Research*, 1964, 24 (4), pp. 7 ff. McCharty E.J., *Basic Marketing: A Managerial Approach, 2nd ed*., Irwin, Homewood, 1964. Bruner G.C., "The marketing mix: A retrospective and evaluation", *Journal of Marketing Education*, 10, 1988, pp. 29 ff. Constantinides E., "The Marketing Mix Revisited: Towards the 21st Century Marketing", *Journal of Marketing Management*, 22 (3), 2006, pp. 407 ff. Dixon D.F., Blois K.J., *Some Limitations of the 4 Ps as a Paradigm of Marketing*, in Blois K.J. (eds.), *Proceedings of the Marketing Education Group,* 1973, pp. 92 ff.

[20] Giacosa E., *L'economia della aziende di abbigliamento*, cit., pp. 293 ff.

[21] Fabris G., *Il nuovo consumatore: verso il postmoderno*, FrancoAngeli, Milano, 2003, p. 174.

[22] Enzensberger H.M., *Zig Zag*. *Saggi sul tempo, il potere e lo stile*, Einaudi, Torino, 1999. Inglehart R., *La società postmoderna*, Editori Riuniti, Roma, 1998.

[23] Moody W., Kinderman P., Sinha P, "An exploratory study: Relationships between trying on clothing, mood, emotion, personality and clothing preference", *Journal of Fashion Marketing and Management,* 14(1), 2010, pp. 161 ff.

its own utility[24], bound not only to material need satisfaction but also to immaterial need satisfaction (dream gratification). For this purpose, besides interpreting market trends, a luxury company should personalise its offering with regards to quality, price and style in order to make the customer feel like they are the protagonist of the commercial exchange. Companies' efforts in this direction are justified by the fact that a product nearer to customers' desires has more potential of generating sale incomes.

A company interfaces with the market by offering one or more "product systems"[25]. For example, BMW's product system is made up of both material products (car and motorcycle lines) and intangible elements qualifying the product, such as status derived from its possession and brand exclusivity. The whole product system, not only one element, must be more competitive than the systems of competitors. If BMW limited itself to a good range of production without offering effective post-sales assistance, customers' fidelity would be compromised and they may choose Audi or Mercedes for their next purchase.

With regards to a product's exposure to style trends, this can be more or less influenced by its own seasonality. In particular, a *luxury product* should be characterised by a never-changing style without the need for an expensive revisiting process by the creative team. As for price, it is not subjected to discounts (with regards to non-affordable luxury) or it is interested by a bending that does not lessen the brand's value. On the contrary, a fashion product has a lifecycle limited to that season's collection (with the exception of basic products) and undergoes strong price reduction during sales or promotional periods in order to dispose of surplus stock. Regarding the distinction between *luxury products* and fashion products, luxury products are easily influenced by fashion. With regards to this influence, we can make a distinction between[26]:

a) *hard goods*: this category refers to a company's historical products, which are less influenced by style seasonality and generate a stable demand bound to particular life events (birth, marriage, birthday, university degree, etc.), e.g. watches and high-level jewellery, whose demand largely depends on such occasions; and

b) *soft goods*: this category refers to a company's products that are more influenced by style seasonality and whose demand is not only occasion driven

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[24] Paquot T., *Elogio del lusso*. *Ovvero l'utilità dell'inutile*, Castelvecchi, Roma, 2007, p. 56 ff. Guatri L., Vicari S., *Il marketing*, Giuffrè, Milano, 1986, p. 597.

[25] Donna G., *L'impresa competitiva*. *Un approccio sistemico*, Giuffré, Milano, 1992, p. 11. Airoldi G., Brunetti G., Coda V., *Corso di Economia aziendale*, cit., p. 333.

[26] Della Bella C., *Value-Value companies nel settore del lusso*, Egea, Milano, 2002, p. 71.

but also linked to typical daily needs. This is the case with haute couture, which, despite style canons firmness typical of the brand, must produce a new collection every season.

A production process can be specialised and complex, depending on the offering's major or minor standardisation degree and the number of production phases:

a) mass production of standardised goods: the company plans the product prototype, which is mass produced without any customisation. The deriving features are standardised[27]. Maisons' young lines are good examples. They do not have any customisation to comply with customer needs;

b) production of customised goods: on the basis of a company prototype, the firm produces internally unique and customised articles with reference to a customer's order. An example would be a custom-made haute couture article. Customer relationship management (CRM) is intensified and realised through strong CRM activity, with which a company's strategy is set by following customers' needs, in virtue of which services and strongly aimed and customised commercial techniques are defined. The company's core interest is represented by the customer, who is given value[28]. The company analyses customers' needs, customers' previous purchase purposes, the features that products must have to satisfy customers' needs and the appropriate ways to convey brand values. CRM employed in a luxury company is not intended to be a detached form of information and technological supremacy. It's a mean to segment customers and find the more suitable marketing mix techniques to apply to each segment. Investments in CRM allow for effective and permanent customer relationships, with particular attention paid to the more profitable ones[29];

c) a company externalises one or more production phases applying to subcontracting[30]. Phases carried out inside the company generally add the most value. Production range variety and quality level also depend on a company's skill in selecting subcontractors, as well as their degree of control on their

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[27] Valdani E., Bertoli G., *Mercati internazionali e marketing*, Egea, Milano, 2006, p. 334 ff.

[28] Choo H.J., Moon H., Kim H., Yoon N., "Luxury customer value", *Journal of Fashion Marketing and Management*, 16(1), pp. 81 ff.

[29] Sacerdote E. (eds.), *La strategia retail nella moda e nel lusso*, Franco Angeli, Milano, 2006, p. 136 ff. Ornati M. (eds.), *Oltre il CRM*, FrancoAngeli, Milano, 2011, pp. 223 ff.

[30] Subcontracting is analyzed in Chapter 4.

operation; and

d) a company produces on customer order[31], following projects provided by the buyer. An example would be an apparel company realising products for another firm as a subcontractor.

Luxury products are *shopping goods* or *specialty goods*[32]. *Shopping goods* refer to the purchase of a product only to satisfy an emotional or psychological need or because the owned object is considered out of fashion. It is marked by a high quality level, a strongly recognisable brand, a high price and a scarce chance to be substituted, since it is subject to differentiation. While purchasing it, the customer compares it to other products, looking for an emotion and for desire satisfaction. Tailor-made clothes, bags and shoes are good examples.

On the other hand, *specialty goods* make reference to a product considered as unique and elitist by the customer thanks to its physical (component qualities, production process innovation and performance) or intangible (brand) elements. Its uniqueness draws the customer towards a targeted purchase, oriented towards a specific product. The customer dedicates time to the purchase, going to well-known points of sales that may even be far from their home or workplace. Such a company adopts a selective or exclusive distribution policy and a high price. Dior and Chanel haute couture for clothing, Ferrari for cars, Gaia Barolo for wine and Hermès for accessories are good examples.

A luxury product presents a series of typical features distinguishing it from both traditional goods and premium products. These features are explained below (Figure 2.2).

[31] Quagli A., *La combinazione dei fattori ed i processi di produzione*, in Marchi L. (eds.), *Introduzione all'economia aziendale*, Giappichelli, Torino, 1998, p. 351 ff.

[32] Pellicelli G., *Il marketing*, cit., p. 240 ff. Saviolo S., Testa S., *Le aziende del sistema moda*, Etas, Milano, 2005, p. 118 ff. Giacosa E., *L'economia della aziende di abbigliamento*, cit., p. ff.

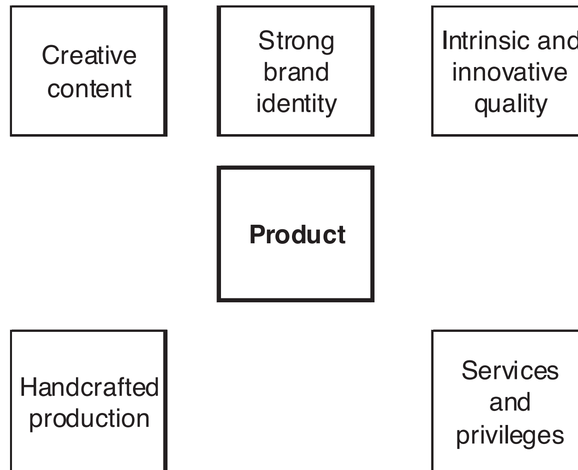

Figure 2.2 Luxury product features
Source: Personal elaboration

A) Creative Content

A product's creative content is derived from the genius and inspiration of a company's creative kernel that plans and carries out new ideas to be turned into products. Thus, the company examines market trends and finds those models allowing its production offer to be renewed whilst keeping its stylistic identity.

Stylistic identity[33] is the main inspiration for a company regarding the creation of collections; it involves permanent stylistic codes that define the production range. Mediterranean baroque for Versace and polo for Ralph Lauren are examples of stylistic identity; coloured knitwear for Missoni, jackets for Armani, bamboo for Gucci and nylon for Prada are good examples of permanent stylistic codes.

As for identity, a creative kernel does not repurpose the same collections from one season to another. It works to keep the brand in line with market trends following its own stylistic identity[34]. An example would be Marc Jacobs joining Louis Vuitton. Starting from ready-to-wear and shoe products, he aimed to revisit collections in terms of keeping shapes but introducing new colours and aesthetic patterns; thus, the collections were enriched by new colour models, such as the multi-coloured monogram.

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[33] Giacosa E., *L'economia della aziende di abbigliamento*, cit., pp. 208.

[34] Kapferer J.N., *The new strategic brand management*, cit., p. 222 ff.

The importance of aesthetics is often more privileged than a product's practical qualities: that is why a Porsche is universally appreciated, despite its noisiness, and why a haute couture dress is appraised even though its tissues are not always comfortable.

A product creator has to be appreciated not only for their engineering qualities but also for the creative genius they employ in their work. Thus, a car designer has to be considered at the same level as a haute couture dress stylist: in his field, Enzo Ferrari has achieved the same esteem that Giorgio Armani receives in the fashion field. Every product conceived by the creative person is a brand values prophet and the market often recognises it as unique, almost like a work of art.

A model becomes a myth when it does not lose its allure over time and keeps the desire to own it alive, becoming immortal; it is not surpassed by following models, even if they are more technologically advanced or modern. Examples include Louis Vuitton's Speedy monogram travel case, which was first realised in the 1920s and was Audrey Hepburn's favourite object, which was reinvented with colour in 2000. Moreover, price often makes a product a myth for its non-affordability in comparison to other luxury or premium products.

A company must combine creative and managerial components; an essential union to survive in the market[35]. Creatives and managerial teams must work together in order to carry out creative choices whilst observing economic and financial balances[36] and even stakeholders' interests[37]. On the one hand, creative

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[35] Dezzani F., *Prefazione*, in Giacosa E., *L'economia delle aziende dell'abbigliamento*, cit., p. XV.

[36] For a long time, Italian literature has focused on the company's economic and financial balances. Though non-exhaustive, the rich national literature that follows illustrates the conditions needed to obtain balances. Giannessi E., *Le aziende di produzione originaria,* volume primo, *Le aziende agricole,* Cursi, Pisa, 1960. Onida P., *Economia d'Azienda,* Utet, Torino, 1965. Ferrero G., *Le analisi di bilancio*, Giuffré, Milano, 1966. Capaldo P., *La programmazione aziendale con particolare riferimento alla programmazione pluriennale*, Giuffrè, Milano, 1965. Ferrero G., *Istituzioni di economia d'azienda*, Giuffré, Milano, 1968. Capaldo P., *L'autofinanziamento nell'economia dell'impresa*, Giuffré, Milano, 1968. Amaduzzi A., *L'azienda nel suo sistema e nell'ordine delle sue rilevazioni*, Utet, Torino, 1978. Ferrero G. Dezzani F., *Manuale delle analisi di bilancio – Indici e flussi*, Giuffré, Milano, 1979. De Sarno M., *Equilibrio e crisi delle imprese*, Cedam, Padova, 1982. Giannessi E., *L'equazione del fabbisogno di finanziamento nelle aziende di produzione e le possibili vie della sua soluzione*, Giuffré, Milano, 1982. Franceschi Rosella F., *Finalità dell'azienda e condizioni di funzionamento*, Seu, Pisa, 1984. Vermiglio F., *Il bilancio sociale nel quadro evolutivo del sistema di impresa,* Grafo, Messina, 1984. Ferrero G., *Impresa e management*, Giuffré, Milano, 1987. Ranalli F., *Considerazioni sul tema dell'economicità aziendale*, Clua Editrice, Pescara, 1988. Airoldi G. Brunetti G. Coda V., *Corso di Economia aziendale,* Il Mulino, Bologna, 1989. Ca-

teams must respect a careful management; on the other hand, the management must consider the needs of creatives, who create the company's image for the market[38].

B) Strong Brand Identity

A brand[39] can be considered as a measure[40] of luxury: a product marked by a luxury brand is also considered a luxury product. Thus, the luxury brand (with

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ramiello C., *Indici di bilancio*, Giuffré, Milano, 1993. Amaduzzi A., *Manuale di economia aziendale*, Cacucci, Bari, 1993. Caramiello C., *Indici di bilancio*, Giuffré, Milano, 1993. Pezzani F. (eds.), *Il bilancio di esercizio nell'informativa esterna d'impresa*, Giuffré, Milano, 1993. Bastia P., *Pianificazione e controllo dei risanamenti aziendali*, Giappichelli, Torino, 1996. Pisoni P., *Le caratteristiche del sistema azienda*, in AA.VV., *Lezioni di Economia Aziendale*, Giappichelli, Editore, 1996. Matacena A. Tieghi M., *Dal bilancio di esercizio alle analisi di bilancio: le riclassificazioni, gli indici ed i flussi,* Clueb, Bologna, 1997. Paolini A., *Le condizioni di equilibrio aziendale,* in Marchi L. (eds.), *Introduzione all'economia* aziendale, Giappichelli, Torino, 1998. Campedelli B., *Analisi aziendale: strumenti concettuali, metodologici e di valutazione dell'impresa*, Giappichelli, Torino, 1998. Beretta Zanoni A., *Pianificazione, controllo e bilancio del valore*, Giuffrè, Milano, 1999. Teodori C., *L'analisi di bilancio*, Giappichelli, Torino, 2000. Marchi L., *Caratteri generali dell'analisi economico-finanziaria riferita al profilo strategico,* in Marchi L. Paolini A. Quagli A., *Strumenti di analisi gestionale*, Giappichelli, Torino, 1997. Melis G., *Elementi di Economia Aziendale,* Giuffré, Milano, 2001. Favotto F., *Economia aziendale*, McGraw-Hill, Milano, 2001. Catturi G. *L'azienda universale*, Cedam, Padova, 2003. Ferrero G. Dezzani F. Pisoni P. Puddu L., *Le analisi di bilancio. Indici e flussi*, Giuffré, Milano, 2003. Cavalieri E., *Creazione di valore, economicità ed equilibrio nel sistema d'impresa*, in Cavalieri E. Franceschi Rosella F., *Economia Aziendale, Vol. I, Attività aziendale e processi produttivi*, Giappichelli, Torino, 2008. Franceschi Rosella F., *L'azienda: caratteri discriminanti, criteri di gestione, strutture e problemi di governo economico*, in Cavalieri E. Franceschi Rosella F., *Economia Aziendale, Vol. I, attività aziendale e processi produttivi*, Giappichelli, Torino, 2008.

[37] Freeman, R.E., *Strategic Management. A Stakeholder Approach*, Pitman, Marshfield Mass., 1984.

[38] Weetman P., *Financial & Management Accounting*, Financial Times/Prentice Hall, London, 1999. Meigs R.F., Williams J.R., Haka S.F., Bettner M.S., *Financial Accounting*, Irwin McGraw-Hill, New York, 2001. Cappetta R., Cillo P., Ponti A., "L'innovazione nel prêt-à-porter: un'analisi longitudinale di Vogue Italia (1984-1999)", *Economia & Management*, 3/2001. Ricchetti M., Cietta E., *Il valore della moda*, Bruno Mondadori, Milano, 2006. Giacosa E., *L'economia delle aziende di abbigliamento*, cit., p. 210.

[39] The term "brand" is used to refer to the name, the term, the symbol, the design or their combination in identifying the product and differentiating it in comparison with competitors' products thanks to its figurative and evocative content. Semprini A., *La Marca. Dal prodotto al mercato, dal mercato alla società*, cit., p. 43. Predovic D. (eds), *Brand. Ma quanto vale?*, Egea, Milano, 2004, pp. 9 ff. Mosca F., *Marketing dei beni di lusso*, Pearson, Milano, 2010, p.

its guarantee and exclusiveness seal) gives a product *luxury status*. Thus, brand philosophy becomes the exaltation of the emotion derived from possessing a product without the need to describe its specific features and practical aspects.

A luxury brand must satisfy a "double qualification process"[41]: on the one hand, the product must be perceived as a real luxury item; on the other hand, it must address universally identified luxury customers. Beyond their high spending aptitudes, they must show the ability to recognise and appreciate a luxury product thanks to their attitude to know how to spend their own money[42]. In Russia, the most successful brands are those that in the past were Tsar favourites. When Richard Mille, the owner of a high-quality watchmaking house, declared the King of Spain among his customers, his expensively priced watches acquired even more appeal. For example, a handmade pullover of excellent cashmere, with a real competitive price and a brand not recognised as a luxury brand in the market, cannot be marked as a luxury product. Thus, this handcrafted good, though allowing the customer to show their good taste, does not create vertical distance compared to traditional goods and it is not luxurious

The luxury nature of a brand can be distorted by strategic mistakes, compromising its capability to generate wealth. In particular, it is important to think about the increase of a brand's dimensional factors, represented by

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98 ff. The distinctive elements of a brand are both tangible, i.e. immediately identifiable (such as the logo, colours and advertising jingle), and intangible, i.e. developed in the customer's mind, producing a brand image (e.g. belonging to a certain social class and the demonstration of a certain level of wealth) Vanderbilt T., *L'anima di gomma. Industria e culture della scarpa sportiva*, Feltrinelli, Milano, 2000, p. 74. Okonkwo U., *Luxury Fashion Branding*, cit., p. 103. Sometimes a brand is patronymic/matronymic, since it carries a person's name and surname, which generally correspond to the founder or initiator of a business dynasty. Logié B., Logié-Naville D., *Leur nom est une marque*, Editions d'Organisation, Paris, 2002. A brand comes to a customer's mind at every purchase: in the first instance, they will choose their favourite brand, releasing themselves from the product and representing a system of values that the individual makes their own. Mariotti J., *Smart things to know about brands & branding*, Capstone, Milford, 1999, p. 17 ff. If a product has a duration due to collection seasonality (excluding basic products), the brand exploits its identity by taking a potential unlimited duration and, however capable of being valid from one season to another, as a guarantee certificate on the company's offer.

[40] Kapferer J.N., Bastien V., *Luxury Strategy*, cit., pp. 107 ff.

[41] Teil G., *Les procédures de qualification des produits de luxe*, in Assouly O. (eds.), *Le Luxe : essais sur la fabrique de l'ostentation,* Editions du Regard, Paris.

[42] Kapferer J.N., Bastien V., *Luxury Strategy*, cit., p. 110.

turnover, number of points of sale and produced pieces. When a brand becomes more available and present in various objects, it risks devaluation. At the same time, even the authorisation of a brand licence to companies operating in different merchandise categories can compromise its exclusiveness due to brand overexposure. The effect deriving from such mistakes, even without causing a bending of demand, can lead to brand devaluation. It occurs the reduction of the stable demand for the *core product* and a decrease in customers' fidelity[43] due to their dissatisfaction with the brand's reduced exclusiveness[44].

A luxury brand's lifecycle[45] is not linear, as is generally the case for more traditional goods[46]. First, it is not always easy to identify its birth, since it is developed gradually. Chanel is an example: it is difficult to determine the brand's date of birth, but it is possible to state that it was born in a period between the birth of Gabrielle Bonheur Chanel (or Coco Chanel) and the conception of Chanel N° 5 perfume. With the exception of ongoing products, products are characterised by a lifecycle contextualised to a season. Beyond the season, they are felt obsolete by the market due to new advertising campaigns that make the products feel out of fashion. As a matter of fact, if the lifecycle of a non-ongoing product ends inside a boutique distribution chain, it continues into outlets; these places provide hope for occasional customers trying to satisfy their desires by buying at reduced prices, even at up to an 80% reduction.

A luxury product's life is not comparable to that of a traditional one: customers' perception can vary considerably in relation to the historical period, socioeconomic conditions or management decisions. For example, at the beginning of the eighties, Gucci underwent heavy difficulties due to product imitation on the market, family conflicts and the choice of launching a lower price product line on the American market. At the beginning of the nineties, Gucci was considered old fashioned and near to bankruptcy; thanks to strong

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[43] Aaker D.A., *Brand equity. La gestione del valore della marca*, Francoangeli, Milano, 1997, p. 64. Okonkwo U., *Luxury Fashion Branding*, cit., p. 118 ff.

[44] Della Bella C., *Value-Value companies nel settore del lusso*, cit., p. 72 ff.

[45] Bontour A., Lehu M., *Lifting de marque*, Editions d'Organisation, Paris, 2002, pp. 13 ff. Mazzalovo G., Chevalier M., *Pro logo. Le marche come fattori di progresso*, FrancoAngeli, Milano, 2003, pp. 155 ff. Corbellini E., Saviolo S., *Managing Fashion and Luxury Companies*, cit., p. 8. Kotler P., Armstrong G., *Principi di marketing,* Pearson, Milano, 2006, p. 351. Foglio A., *Il marketing nella moda,* Franco Angeli, Milano, 2007, p. 61 ff.

[46] Kapferer J.N., Bastien V., *Luxury Strategy*, cit., pp. 156 ff. Terzani S., *Controllo di gestione nelle imprese di alta moda*, Franco Angeli, Milano, 2007, p. 19 .

changes in customers' tastes, company reorganisation and to Tom Ford and Domenico De Sole's team, the brand was brought back into the international arena, both for leatherwear and for other clothing. Thus, the brand found its allure again. A company can feel obliged to redefine a product line or even a whole merchandise category. ST Dupont is an example of this: the company transitioned from the luxury lighter business to pens, always keeping its luxury brand status.

When a brand is very popular, or even better has become a myth, it becomes immortal; time makes its allure stronger, but the company must know how to reappraise it in a modern way or revive its past splendour. A brand can last thanks to one or more icons symbolising its values. Chanel N° 5 is Chanel's icon, just as the Kelly bag is for Hermès. Some aspects of the design, colours and packaging might change, but the traditional product lines remain unaltered over time, so that the customer can recognise traditional values in a perfume bottle rather than in a leather bag.

A product's lifecycle is strongly decided by its past, which is kept in customers' minds through myth reinterpretations; such reinterpretations might refer to the stylist (e.g. Coco Chanel's apartments were visible on Chanel's website) or to an iconic product (such as Gucci's Flora foulard revival). The secret lies in the re-examination of past traditional values and in demonstrating the ability to express current tastes and, at the same time, generate future ones. Chanel's launch of surfboards demonstrates a luxury company's ability to catch market signals, take new business opportunities and confirm its attitude towards satisfying every new need of its most attached customers.

Correct brand marketing[47] is necessary in order to keep its allure unaltered. This is a fundamental aspect, since the brand represents an important intangible asset[48]. For this purpose, a company must strengthen, if necessary, its brand's communicative choices: a fashion company using Facebook to reach younger customers is an example of this.

In the luxury market, visible logos and brands[49] are strongly present. This especially occurs with the most widespread objects: that is, the more affordable ones. This is the case with accessories, which are generally the first luxury products chosen by less wealthy customers, or some less expensive cloth-

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[47] Kapferer J.N., *Re-inventare la marca. Potranno le grandi marche sopravvivere al nuovo mercato?*, Franco Angeli, Milano, 2002, p. 136.

[48] Fabris G.-Minestroni L., *Valore e valori della marca*, Franco Angeli, Milano, 2004, p. 14.

[49] Kapferer J.N., Bastien V., *Luxury Strategy*, cit., pp. 105 ff.

ing items. Chanel's bags, wallets, sunglasses and t-shirts, as well as Louis Vuitton's monogram on leather products, are some examples.

Generally, a logo is more evident on affordable luxury products; thus, the logo becomes a powerful marketing instrument. By contrast, more valuable products exhibit the brand through intrinsic qualities or a series of identifying signs typical of its creator, e.g. a dress style or a design shape. In fact, a dress from Hermès first collection does not show a big logo, while a bag usually displays it.

A luxury brand must always keep its own brand identity[50] alive. This encourages the most affectionate customers' involvement in creating a cult, almost like respecting a devotional spirit[51]: a brand acquires ideological connotations[52], generating a strong relationship between customers and the brand[53]. A luxury brand is almost the incarnation of its creator, often carrying their name. Chanel is Coco Chanel's creation, Valentino of Maestro Valentino, Hilton hotels chain is the Hilton's family creation, and so on. It follows that these brands are deeply rooted and were not created from nothing.

Apart from brand age, each new product must be in line with the intrinsic values of such identity, always aiming at satisfying variable customers' needs. The Hermès Kelly bag represents the most expensive bag worldwide. Purchasing it not only means buying the bag but also expands to a universe (that of Hermès) that represents a myth and almost a world by itself, where the aristocratic and elegant style of French vogue dominates.

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[50] Joachimsthaler E., Aaker D.A., *Building brands without Mass Media,* in AA.VV., *Harvard Business Review on Brand Management*, Harvard Business School Press, Harvard, 1999, p. 5. De Chernatony L., *From Brand Vision to Brand Evaluation. Strategically Building and Sustaining Brands*, Butterworth Heinemann, Oxford, 2001, pp. 20 ff. Vaid H., *Branding,* Cassel Illustrated, London, 2003, pp. 126 ff. Okonkwo U., *Luxury Fashion Branding*, cit., p. 110 ff. Ross J., Harradine R., Fashion value brands: the relationship between identity and image, *Journal of Fashion Marketing and Management*, 15(3), 2011, pp. 306 ff.

[51] Carmagnola F., Ferraresi M., Merci di culto. Ipermerce e società mediale, Castelvecchi, Roma, 1999, pp. 41 ff. Ragas M., Bueno B.J., *The Power of Cult Branding. How 9 Magnetic Brands Turned Customers into Loyal Followers (and Yours Can, Too!)*, Prima Venture, New York, 2002. Cornell A., "Cult of Luxury: The New Opiate of the Masses", *Australian Financial Review*, April, 27, 2002, pp. 47 ff.

[52] De Martini A., *La comunicazione people oriented. Un nuovo modello per la comunicazione d'impresa*, Guerini e Associati, Milano, 2002, pp. 15 ff.

[53] Lindstrom M., Clicks, *Bricks & Brands. Ovvero il matrimonio tra economia on-line ed economia off-line*, Etas, Milano, 2002, p. 3.

Behind a luxury company's success, there is often the will to stand by its brand's traditional values, keep its identity and avoid bending to customers' needs at any cost.
This is especially true when satisfying such needs does not allow the company to stay in line with the brand's deep values. For example, the BMW 5 series, loved by the market, is not always considered comfortable due to the space provided to passengers in the back seats. Anyway, the car company has not followed customers' suggestions in order to avoid ruining the purity of the design and the aesthetic symmetries. Thus, the company respects its brand's values, dominating the product demand and drawing demand towards the product, even though its features are not completely in line with real needs.

A brand acquires a *visual identity*[54], both cognitively and in the purchasing moment. Thanks to its value, a brand generates so-called *goodwill*: that is, the psychological tendency towards the brand itself displayed by the customer, by the distributor or seller (for example, assuring the presence of the brand in the strategic positions of a boutique) and by other chain operators. *Goodwill* represents an intangible asset that a brand acquires slowly and is displayed when an individual shows appreciation and a predisposition towards that brand[55]. Goodwill is the expression of intangible assets generated by a company's communication processes and fed by interlocutors' trust in the company[56].

Brand value has been the subject of various studies aiming to quantify its entity[57]. The purpose is to evaluate a brand's influence on the increase of com-

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[54] Fabris G., Minestroni L., *Valore e valori della marca*, cit., p. 211.

[55] Randall G., *Branding*, Kogan Page, London, 1997, p. 25 ff. Kapfefer J.N., *Les Marques. Capital de l'Enterprise*, Editions d'Organisation, Paris, 2000, p. 19. Giacosa E., *L'economia delle aziende di abbigliamento*, cit., p. 312.

[56] Vicari S., *L'impresa vivente. Itinerario in una diversa concezione*, Etas Libri, Milano, 1991, p. 85. Vicari S., *Brand Equity. Il potenziale generativo della fiducia*, Egea, Milano, 1995, p. 17.

[57] For more details on brand equity, please refer to the following authors. Guatri L., *La valutazione delle aziende. Teoria e pratica a confronto*, Egea, Milano, 1990. Murphy J. (eds.), *Brand Valuation*, Business Books, London, 1991. Aaker D.A., *Managing Brand Equity*, The Free Press, New York, 1991. Bertoli G., *Relazioni interaziendali e acquisizione di capacità per lo sviluppo della marca*, in Vicari S. (eds.), *Brand Equity. Il potenziale generativo della fiducia*, Egea, Milano, 1995. Busacca B., Verona G., *La brand equity nella prospettiva delle imprese*, in Vicari S. (eds.), *Brand Equity. Il potenziale generativo della fiducia*, Egea, Milano, 1995. Ambler T., *Measures of brand equity,* Journal of Brand Management, 2, 6, 1995. Aaker D.A., Brand equity. La gestione del valore della marca, Francoangeli, Milano, 1997. Zara C. (eds.), *La valutazione della marca*, Etas Libri, Milano, 1997. De Chernatony L., *From Brand*

pany's intangible asset value[58]. Thus, brand value depends on both the relationship between a company and its customers, and the relationship with other interlocutors[59]. The following table shows some luxury companies' brand values operating in various sectors; it is a 2011 table referring to the 100 most valued brands worldwide (Table 2.1).

Vision to Brand Evaluation. *Strategically Building and Sustaining Brands*, cit.. Aaker D.A., Joachimsthaler E., *Brand leadership*, FrancoAngeli, Milano, 2001. Keller K.L., *Strategic Brand Management: Building, Measuring, and Managing Brand Equity*, Prentice-Hall, New Jersey, 2003. Busacca B., Keller Lane K., Ostillio M.C., *La gestione del brand,* Egea, Milano, 2005. Okonkwo U., *Luxury Fashion Branding*, cit. Mariano L., Megido V., *Brand imagination*. *Le nuove frontiere dalla marca,* Isedi, Torino, 2007. Kim H.J., "The dimensionality of fashion-brand experience: Aligning consumer-based brand equity approach", *Journal of Fashion Marketing and Management*, 16(4), 2012, pp. 418 ff.

[58] Randall G., *Branding*, cit., p. 112. AA.VV., *The future of Brands: Twenty-five Visions,* Interbrand Newell and Sorrel, New York University Press, New York, 2000, p. 20 ff. Golinelli G.M., *Ridefinire il valore della marca,* Sinergie, 63, 2004, 221 ff.

[59] Feldwick P., *What is Brand Equity, Anyway?*, World Advertising Research Center, Henley on Thames, 2002, p. 27.

Table 2.1 Brand values of main luxury companies worldwide

Position in 2011 rank	Position in 2010 rank	Brand	Country of origin	Sector	Brand value (million dollars) in 2011	Value variation versus 2010
12	12	Mercedes	Germany	Automotive	27,445	9%
15	15	BMW	Germany	Automotive	24,554	10%
18	16	Louis Vuitton	France	Fashion	23,172	6%
39	44	Gucci	Italy	Fashion	8,763	5%
59	63	Audi	Germany	Automotive	6,171	13%
66	69	Hermès	France	Fashion	5,356	12%
70	77	Cartier	France	Jewellery and watches	4,781	18%
72	72	Porsche	Germany	Automotive	4,580	4%
73	76	Tiffany & Co.	United States	Jewellery and watches	4,498	9%
77	79	Moët & Chandon	France	Alcohol	4,383	9%
93	95	Armani	Italy	Fashion	3,794	10%
95	100	Burberry	United King-dom	Fashion	3,732	20%
100	98	Ferrari	Italy	Automotive	3,591	7%

Source: Best Global Brands 2011, Interbrand, 2012.

The first 100 brands worldwide represent several sectors, especially automotive and fashion sectors. Automotive sector brands lead in visibility in the luxury sector, particularly Mercedes in 12th place and BMW in 15th place. Their brand values have increased by 9% and 10% respectively in comparison to 2010, demonstrating an interesting trend, even contextualising it within the decrease in consumption in the automotive sector. The Audi brand is more distant, in 59th place, with a 13% increase. The Porsche (in 72nd place) and Ferrari (in 100th place) brands experienced more limited growth in comparison to the previous year since they represent a luxury conceived for an élite few.

As for the fashion sector, Louis Vuitton is the first brand, in 18th place, with a 6% increase, followed by Gucci in 39th place, with a 5% increase.

Hermès has grown more, with a 12% growth rate from 66th place. Italian fashion is represented by the Armani brand, in 93rd place, with a growth of 10%. The British brand Burberry, in 95th place, has remarkably improved its trend with a 20% growth rate: the highest increase obtained in the first 100 brands worldwide.

Jewellery and watches, and wines and spirits are the other two sectors present in the chart. The first sector is represented by Cartier and Tiffany & Co.: Cartier is in 70th place with an interesting 18% growth rate; Tiffany & Co. is in 73rd place with a small increase. As for the second sector, Moët & Chandon is the first brand with a 9% growth rate.

The following figure compares the trend of main brand values from 2002 to 2011. (Figure 2.3). Louis Vuitton's brand value is predominant in its main sector (fashion) and in other luxury sectors (jewellery and watches); even its trend growth shows the brand's ability to develop high visibility worldwide.

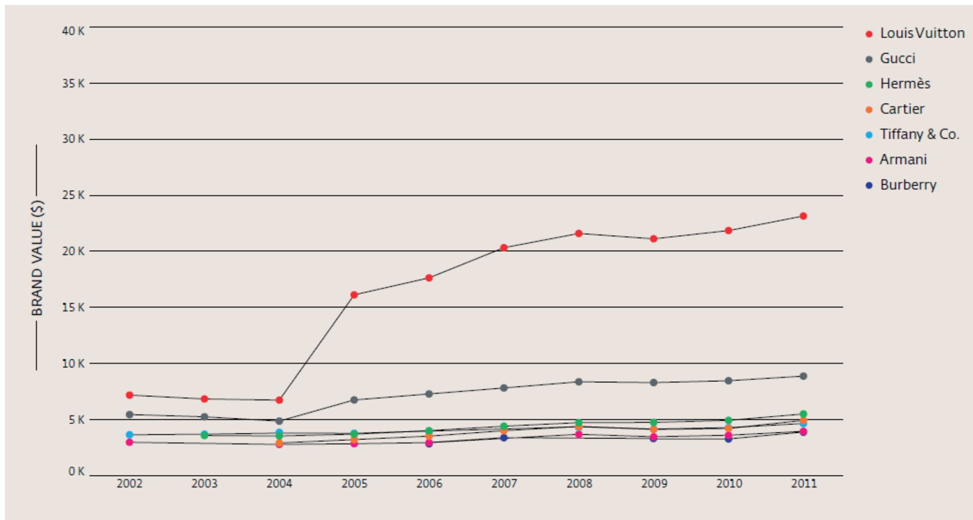

Figure 2.3 Comparison of brand values of main luxury brands

Source: Best Global Brands 2011, Interbrand, 2012

Luxury companies are characterised by a *heavy brand*: that is, the brand represents the most significant asset of the company. Its strength allows the company to be a strong *cash generator*: namely, to generate high volumes of free cash flow even in the absence of expansive investments[60]. Case histories

[60] Della Bella C., *Value-Value companies nel settore del lusso*, Egea, Milano, 2002, p. 63.

in the luxury market prove that the value drivers[61] of the success of a brand are represented by its tradition, felt to be synonymous with experience, and by design, production and quality control know-how. It follows that even small- and medium-sized companies have developed high-value brands with international impact.

Brand value allows a high profitability level, despite the strong competition between luxury houses, and also thanks to the reduced pressure of customers; in the luxury market, customers' negotiating power is reduced, due to both reduced sensibility to price increases and the offer rareness felt by the customer. On the contrary, customer pressure is high in the *consumer goods* market.

C) Intrinsic and Innovative Quality

The raw materials used to realise a luxury product must be of high quality; the production processes must also reach high effectiveness and efficiency levels. Components' intrinsic quality often adds to the strong product innovation that allows differentiation from competitors' production ranges. In particular, in the affordable luxury sector, the innovation factor has reached high acceleration[62].

"Made in Italy" luxury is globally recognised thanks to its raw materials' quality and to its often handcrafted manufacturing processes, which make it a valuable and qualitative product. Components and production processes quality are necessary to allow the product to last (as a valuable hides able to resist wear over time and bad weather) and increase its value over time (for example, a Louis Vuitton trunk or a precious red wine bottle).

Product innovation is also influenced by the technological level that slows down its obsolescence. It follows that modern luxury products are in line with progress and technology. One example of this is Ferrari cars. They are well-known worldwide not only for their bright colours, design and status symbol but also for their performances derived from the advanced technological formula. Technology is not an end in itself but an aspect of customer perception; thus, technology has to be considered as a method through which a consumer can better perceive a product's material and immaterial attributes.

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[61] Zara C. (eds.), *La valutazione della marca*, cit., pp. 40 ff.

[62] Silveerstein M.J., Fiske N., *Trading up. La rivoluzione del lusso accessibile*, Etas, Milano, 2004, p. 64. Bruce M., Hines T., *Fashion Marketing. Contemporary Issues,* Elsevier Ltd, Riverport, 2007, p. 138 ff.

The technological factor often contributes to justify a product's price, often giving the product an intrinsic value that is assessable in an objective way. Strategy excellence lies in the right compromise between the technologic and handicraft ingredients to be measured in relation to the considered product typology: in a Riva yacht, one feels the traditional mark of its production process, but at the same time even the technological aspect realises a union of performance and comfort. Technology is at the service of the product's status and of the customer's dream: Rolls-Royce, an aristocratically royal symbol, revealed itself poor in technology and obsolete: after the acquisition by BMW, the model was revised thanks to a technological injection, as well as a new design.

The intrinsic factor is necessary for a luxury product's survival in the market; this makes the customer appreciate its functional characteristics and brand status. The fidelity matured towards a brand might disappear if the customer is attracted by a similarly attractive brand; by contrast, a product with confirmed functional characteristics is abandoned with more difficulty. Thus, luxury not only depends on brand strength. Also product's internal characteristics increase appreciation and make its identity stronger, generating a "multi-sensorial" effect[63] in the customer's mind.

D) Handcrafted Production

A luxury product must be perceived as the result of handcrafted production or almost be considered as a work of art. Handcrafted production represents a differential factor that helps to improve the image of a high-quality product (e.g. a *haute couture* dress). Nevertheless, sometimes the advertising message is designed to make customers perceive the handcrafted origin of the product, even though it derives from mass production. For example customers like to imagine that a designer perfume is created in the stylist's laboratory. As a matter of fact, the majority of luxury products are not completely derived from handcrafted production. However, a luxury company has the ability to convince customers of those handcrafted components as the exclusive ingredients of the product. For example, during his advertising messages, Patek Philippe exalts a model number of hand-polished components, exalting the watch as if it were a work of art.

Custom-made products always represent the male offer of the higher segment, where the big sartorial brands create the style: Kiton, Brioni, Borrelli and Loro Piana are some examples. These were joined by great labels that

[63] Kapferer J.N., Bastien V., *Luxury Strategy*, cit., p. 40.

perceived the potential of customisation as the key to the wardrobes of wealthy and expert customers. Giorgio Armani realised a men's line that was entirely handmade and customised: at the boutique, the customer chooses the tissue, every accessory, detail and length, besides the necessary fitting.

E) Services and Privileges

A luxury product must offer the customer a series of important services and privileges exalting its possession and utilisation. Service refers to the human touch with which a customer's needs and desires are observed and anticipated[64]. To do so, luxury companies must put effort into respecting and listening to the customer. Moreover, every subject involved in the production-distribution chain must be drawn by their passion for the role, since they must convey beauty and express their pride of belonging to the company and a brand. This justifies the careful training and the improvement of points of sale staff: the seller is the joining element between the customer and the brand. The seller is a part of a long process aiming to satisfy every customer's desire; he's the brand's "sales ambassador"[65].
The exclusivity of a product also depends on emotions[66] and the satisfaction degree after purchase: thus, service must include every phase of the contact between the customer and the company, from outside the point of sale until the following enjoyment of the product or service. A luxury car must have a distinctive post-sales service compared to that of a traditional car. Otherwise, the customer could become bewildered and dissatisfied. Besides the typical post-sales services, some car companies selling luxury products are differentiated in some details regarding the customer relationship: through agreements with the main luxury hotel chains, the customers can have their cars parked in front of the hotels, giving further satisfaction to their customers. Moreover, many companies employ the community method, where their customers meet one another or converse with the purpose of consecrating a product that many consider a myth. For example, Ferrari has created a community of old Ferrari owners, who are invited to Maranello for their car testing and servicing.

In order to guarantee its customers a series of privileges, a company must

[64] Corbellini E., Saviolo S., *L'esperienza del lusso*, cit., p. 158 ff.

[65] Lent R., *Vendere lusso*, Il Sole 24 Ore, Milano, 2011, p. 17.

[66] Gobé M., *Emotional Branding: The New Paradigm for Connecting Brands to People*, Allworth Press, New York, 2001, p. X.

adopt a policy focused on élite[67], abandoning democratic principles of luxury. This provokes a differentiation attitude inside the market segment, giving origin to various customers sectors: those to be addressed with standard services and those to be addressed with detailed services. Besides reserving a delimited area to business class, airline companies avoid the meeting of first class customers and second class ones, almost managing them separately, as if the first class customer were flying on a private jet.

The hotel sector offers the greatest differentiation service, in particular making a strong distinction for super-luxury service. The customer receives an atmosphere[68] that is as comfortable as home, with refined design and a series of customised services providing added value. Some chains aim to provide a standardised service of a high level that permits the customer to find the same settings anywhere (for example, Hilton and Sheraton).

2.2.2 Price

Price is a lever used by companies to increase the product's desirability by making it even more exclusive and unique[69]. "Consumer remember the quality, but forget the price" said Aldo Gucci. Luxury customers, convincing themselves of the intrinsic value of luxury products, buy anything without consideration for the price. Non-affordable luxury products are put on the market at a high price, even though this is not always justified by the intrinsic quality of the components and production; on the contrary, it is confirmed by the power of the brand image (in some cases of strong brand appeal, the accessory price can be fifty times its production cost).

Luxury must not be confused with money: if in China luxury customers tend to exhibit dresses with their price tags, the management exclusively focused on the price factor in order to stimulate market desire would lose sight of the exclusivity element suggested by the product's intrinsic nature. Of course, money can be considered as the "gasoline" allowing the "luxury engine"[70] to work, since a lack of it would not permit the purchase of luxury products.

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[67] Kapferer J.N., Bastien V., *Luxury Strategy*, cit., p. 94.

[68] Parsons A.G., "Atmosphere in fashion stores: do you need to change?", *Journal of Fashion Marketing and Management*, 15(4), 2011, pp. 428 ff.

[69] Erickson G.M. and Johansson J.K., "The Role of Price in Multi-Attribute Product Evaluations", *Journal of Consumer Research*, 12, 1995, pp. 195 ff.

[70] Kapferer J.N., Bastien V., *Luxury Strategy*, cit., p. 51.

A product's price must not decrease under a certain level: if it decreases too much, the affectionate customers could perceive it as no longer exclusive and immediately associated with the premium category[71]. This is the case with valuable wine bottles, often sold in well-supplied shopping centres and also in quality wine shops: commercial offers aiming to sell at a lower price might decrease the purchasing of that wine, since it might lose its luxury product value. The damage to the brand image deriving from the price decrease could be superior to the economic benefit of the operation. Regarding Mercedes' launch of Smart, the aim was to vary the production range towards a lower target, entering non-luxury market segments. In this case, Smart had to represent a Mercedes premium product. However, customers do not seem to have appreciated this brand expansion as much as the car company expected; thus, Mercedes is still considered to be a luxury brand and this is not perceived by the premium segment.

At the same time, a price increase must not exceed a given legitimacy threshold, beyond which the relation between price and the dream to be realised is no longer justifiable by the customer[72]. This acceptable threshold[73] is influenced by prearranged objectives regarding the pricing policy, product cost, demand and competitors and by intangible factors such as the capability to satisfy the customer's dream[74]. The company needs to know how to raise the legitimacy threshold, and to respect actual and potential customers' perception: if this should not happen, the company will lose a segment of the market.

When the price product is perceived as correct by the consumers, every increase must be accepted as a return for the satisfied dream. Increasing a product's intrinsic value is not enough; it is necessary to make the customer aware that the product is more suitable to satisfy a new need. Sometimes a company realises an advertising campaign to make price increases more comprehensible. For example, when Louis Vuitton had to increase its product prices in Japan due to currency exchange rate fluctuations, the company explained its reasons using press advertising.

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[71] Dubois B., Czellar S., "*Prestige Brands or Luxury Brands? An Exploratory Inquiry on Consumer Perceptions*", Marketing in a Changing World: Scope, Opportunities and Challenges: Proceedings of the 31st EMAC Conference, University of Minho, Portugal, 28-31 May 2001.

[72] Ciappei C., Surchi M., *Il lusso nel dettaglio*, Firenze University Press, Firenze, 2008, p. 93.

[73] Lichtenstein D., Block P., Black W., "Correlates of Price Acceptability", *Journal of Consumer Research*, 15, 1988.

[74] Pellicelli G., *Il marketing*, cit., p. 305 ff.

The price lever must not be considered the main key to raising a premium product to luxury status, automatically increasing its price: the company must instead know how to convey a series of material and immaterial attributes perceivable by the customer that make the product highly exclusive and elitist.

The searches of customers at any cost based on price do not represent part of a luxury company's strategy for its brand: spreading the target and trying to absorb premium customers could be a wrong move that could damage the brand's exclusivity. On the contrary, a company concentrating on its own reference target could enter new markets, as well as keep the luxury buyers segment.

If price increases with traditional goods cause demand reduction, in the luxury market this rule is contradicted[75]: price growth can attract a new customer segment not interested in the product before because it was perceived as non-exclusive. In order to achieve such an effect, a company must invest in increasing the product quality and strengthening the communication messages. At the same time, a company could lose non-affectionate customers that are potentially the less profitable customers. A customer, even a luxury one, shows a reaction to a price, since pricing is a communication method.

It follows that a company's policy must not be oriented to increasing the number of customers through a price reduction; it must aim to increase its market segment towards exclusive customers instead, who are potentially interested in consecutive and regular luxury purchases. Initial moves can be those referring to high-price luxury articles but with a lower absolute value, such as accessories, that are more affordable.This is Louis Vuitton's policy for leather goods (wallets, key cases and the Speedy travelling case) and Tiffany's for objects with lower intrinsic value. On the contrary, the concentration on day trippers can demonstrate a brand decline that could lead it to premium status.

This is why luxury company such as Louis Vuitton do not offer sales and discounts but offer everyday high pricing, keeping a high price for the whole season without ever granting discounts. The sales philosophy, seen as the selling-off of a product (and its brand), is not part of luxury's DNA, at least for non-affordable luxury. At the end of the season, unsold non-ongoing products are even destroyed instead of being discounted or sold to wholesalers: this avoids brand devaluation. However, there are many companies that are perceived as luxury companies (particularly affordable luxury companies) that

[75] Veblen T., *The Theory of the Leisure Class*, Gallimard, Paris, 1970. Casiccia A., *Lusso e potere*, Bruno Mondadori, Milano, 2008, p. 34 ff.

offer discounts at the end of the season, applying the *high/low pricing* policy by fixing a high price during the season and reducing it during sales. For instance, in Via Montenapoleone in Milan on the first sales day queues of Italian and foreign customers wait for the event. This policy can be considered disrespectful for affectionate customers, since they paid the whole price at the beginning of the season; moreover, it makes the price lever stronger, minimising the importance of the brand and the product, which should represent extremely relevant elements in the luxury sector.

It is not correct to say that sales should not take place in the luxury sector; more precisely, sales must not regard the brand but some less representative products of a collection of that brand. Dior's ongoing products are not put on sale, unlike more trendy articles that cannot be sold in boutiques in the next season. However, price reduction has a positive effect: it allows the number of occasional customers to spread, even though it is temporary. Moreover, it draws customers to enter into boutiques and to do *window shopping*, feeding their desires that could become purchases in the future.

Offering price reductions for particular customers is a different policy. In this case, the price is not decreased, but the customer's value is increased: for accurate customisation, the company offers privileged aspects to a customer segment, giving them the opportunity to make a deal. Generally, they are referred to as "affectionate customers" for their fidelity. It can also refer to a selected segment of potential customers[76], attracted by the opportunity for concomitance with a particular event: the brand is not devalued, since the event justifies the commercial offer (e.g. a wedding or a birth).

The comparison between luxury products with reference to their price is quite difficult: both because the purchase is not so frequent, leading to the customer forgetting the price paid, and because products are specific, making them difficult to compare. Moreover, this kind of comparison does not represent the lever of *luxury companies'* strategies: the brand and, consequently, the praised product, are the lever, while the price is often considered an offer detail. On the contrary, the price factor can represent a distinctive element when its prohibitive level distinguishes the product from those of competitors, making it emerge as the most expensive product in its category worldwide: the Bugatti Veyron, advertised as the most expensive car worldwide, is a good example. However, it is a tricky policy, since it involves the risk of obtaining opinion leaders' disappointment regarding the insubstantiality of the relationship between the price and the intrinsic value of the product. It could lead to

[76] Bogart L., *Strategia in pubblicità. Come combinare media e messaggi con mercati e motivazione*, FrancoAngeli, Milano, 1990, p. 338.

company failure and, worse, to customer failure. In fact, customers who have been affectionate to a certain kind of luxury for a long time are generally deep experts of the brand as well as of the value of the product to be purchased.

The price variable can create some confusion between luxury and premium products: over the last few years, the prices of traditional non-essential products have increased, while "new entry" luxury products have followed the inverse course. This has led to a sort of "lining up" between premium and luxury prices in the same merchandise category: Lancôme and Chanel for face creams or perfumes, and Lexus and Audi for cars. This demonstrates that price does not represent the only distinguishing element of a luxury product.

2.2.3 Promotion

Unlike what happens in traditional marketing, the role of communication in luxury marketing is not about selling but about conveying an exclusiveness message and growing or feeding desire. Thus, communication must not describe the product but distinguish it from others[77], pointing out the absolute values of the brand[78].

As for fashion company, fashion shows represent the top of the communicative activity: they are not only exhibitions of the production range but also demonstrations of creative attitude[79]. In explaining his work, a BMW manager described the communicative efforts to feed his eighteen-year dream of possessing a BMW car as soon as they became financially available to him. Thus, the commercial objective puts the dream first and then the selling, even though within the limit of economic and financial balances. As for a Ferrari dealer, a good seller should emphasise those aspects contributing to mythicise the product, such as the speed, road handling, seat comfort and waiting time, and only afterwards talk about price with the customer: by contrast, the commercial policy for a low-powered car will have to put cheapness first.

Promotion is a method of making a brand visible to a wider range of customers[80], feeding their dreams and appealing to models represented by famous personalities. Thus, communication increases brand visibility, thanks to con-

[77] Kapferer J.N., *Ce qui va changer les marques*, Editions d'Organisation, Paris, 2002, pp. 29 ff.

[78] Arnold D., *The Handbook of Brand Management*, Perseus Books, Boulder, 1992. Michel G.., *La stratégie d'extension de marque*, Vuibert, Paris, 2000.

[79] Lipovetsky, G., Roux, E. 2003. *Le luxe éternel. De l'âge du sacré au temps des marques*, Gallimard, Paris.

[80] Giacosa E., *L'economia delle aziende di abbigliamento*, cit., p. 325 ff.

siderable advertising investments, the employment of famous models and testimonials, and high impact outdoor spaces and points of sale locations in outstanding places.

Luxury product communication does not focus on price; on the contrary, this is often omitted. This derives from the fact that the faithful luxury customer is not attracted by the moderateness or not of a purchase price, but by other attributes and by the company behind the product, in terms of experience, attitudes, behaviour, design, style, language, ecology and so on[81]. Generally, a luxury company can take the liberty of creating a product and defining its price afterwards. This does not happen in the traditional market, where the price lever is often the first thing on which the company bets (Ryanair's aggressive offers and quite competitive prices are an example).

The communication channel[82] is employed to change its interlocutors' behaviour and to persuade them to accept a commercial offer and prefer it to competitors' offers[83]. The communicative policy must, on the one hand, strengthen the brand identity regarding continuity and, on the other hand, refer to its modernity using new communication choices[84]. The communicative message is effective if it is derived from careful consideration of the individual purchase reasons of the customer, the brand image and style trends, looking for predominance regarding competitors and sometimes depreciating competitors' moves[85]. In order to avoid brand trivialisation, the message must lead to the identification of its core meanings[86]. Using a particularly incisive slogan, a brand must refer to the customer's private sphere, taking out that hedonism and narcissism typical of an individual beings[87]: Chanel's Egoïste perfume is an example.

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[81] King S., "Brand building in the 1990's", *Journal of Marketing Management*, 7, 1990, p. 3.

[82] The different communication channels used in the luxury sector can be separated into different categories: seasonal, institutional and relational. For an in-depth study, refer to Saviolo S., Testa S., *Le aziende del sistema moda*, cit., p. 266 ff. Giacosa E., *L'economia della aziende di abbigliamento*, cit., pp. 329 ff.

[83] Pellicelli G., *Il marketing*, cit., p. 449 ff.

[84] Fabris G., Minestroni L., *Valore e valori della marca*, cit., p. 258 ff.

[85] Volli U., *Contro la moda*, Bompiani, Milano, 1988, p. 127.

[86] Kapferer N.J., Laurent G., *La sensibilité aux marques*. *Marchès sans marques*. *Marchès à marques*, Editions d'Organization, Paris, 1992, p. 15.

[87] Semprini A., La marca. *Dal prodotto al mercato, dal mercato alla società*, Lupetti, Milano, 1996, p. 93.

The communicative message must not only focus on its own luxury reference target; it must also address the customer segment that is not wealthy enough to purchase a luxury product. This expands the market's *brand awareness*[88], making the product even more enviable and exclusive. On the contrary, if a brand were only recognised by already affectionate customers, its value would decrease.

Luxury companies are protagonists of a communicative policy of great impact where the product is sustained by famous testimonials[89] (such as from actors and models) and by large advertising spaces in specialised magazines, newspapers and public places and on television. The spot often becomes a short film created by famous directors on international sets. This means high advertising investment for the company. The use of testimonials must be studied with attention: on the one hand, the testimonial's fame could produce a benefit for the brand; on the other hand, the testimonial could reveal itself to not be perfectly in line with the brand identity[90]. To avoid this, it is necessary to identify the brand strategy first and then the testimonial. Moreover, there is the risk of admitting that the brand needs a star to be popular and recognised. It follows that the testimonial must not reduce the product to a simple accessory but exalt its specificity and values. For example, in the Louis Vuitton advertising campaign with Mikhail Gorbachov, the chosen figure had a fundamental political role in the international context.

The efficacy of a communicative policy is also measured by the brand's international value: a luxury product must be easily recognisable worldwide or, rather, in the wealthiest areas. When a product is recognised and valued by different nationalities, it demonstrates its global appeal. To increase the international impact, companies aim to sell goods in more prestigious cities (Paris, London, New York, Los Angeles, Milan, Hong Kong, Dubai, etc.). Strong

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[88] The term "brand awareness" refers to the intensity of the relationship between the brand and the product typology perceived by the customer. A strong brand develops a very intense relation between the product and the brand itself. Every time a customer shows need for a certain product, their thought goes immediately to the brand with more brand awareness. Ciappei C., Surchi M., *Il lusso nel dettaglio*, cit., p. 106. Kapferer J. N., *Les marques à l'épreuve de la pratique*, Editions d'Organization, Paris, 2002, p. 200. Okonkwo U., *Luxury Fashion Branding*, cit., p. 113 ff. The consequence is strong brand saliency, since the brand comes to the customer's mind spontaneously before those of competitors. Lombardi M. (eds.), *Il dolce tuono. Marca e pubblicità nel terzo millennio*, FrancoAngeli, Milano, 2000, p. 74. Zara C. (eds.), *La valutazione della marca*, cit., p. 5.

[89] Giacosa E., L'economia delle aziende di abbigliamento, cit., p. 334.

[90] Okonkwo U., *Luxury Fashion Branding*, cit., p. 156 ff.

international value attracts transnational customers[91], who, with the same characteristics even though they are of different nationalities, represent potential luxury customers. Wealthy tourists who travel all over the world and are strongly attracted by Made in Italy product are an example. This is the case with Chinese tourists in Italy: they represent an example of a "global shopper", i.e. tourists who consider shopping a fundamental aspect of their tour. During the last three years, Chinese purchases have increased constantly: in 2009, growth was 72% compared to the previous year. In 2010, the registered growth was 109% and in 2011 it was 36%. In particular, between January and May 2012, the most concerned merchandise category was clothing (63%), with an average expense of 700 euros, followed by jewellery (29%), which registered a 110% increase compared to the same period of the previous year with an average expense of about 5,634 euros[92].

International value is often linked to specificities deriving from the geographical origin of a product: when a customer enters one of the Salvatore Ferragamo boutiques present worldwide, they want to breathe in an Italian atmosphere.

Advertising represents the main promotion method. Luxury companies make remarkable advertising investments, both for the institution and for the product. The following table illustrates the trends in the advertising investments of the main 50 global fashion and luxury brands into the Italian press[93]. The total investments of 2011 amounted to 702.9 million euros, registering an increase of 9.7% compared to 2010. Even if the advertising sector is affected by the economic crisis, luxury advertising is increasing (Table 2.2).

[91] Gehrke B., Sportelli M., "La sfida del lusso negli Emirati Arabi Uniti", *Economia & Management*, 4/2010, p. 26 ff.

[92] I cinesi tra i Top Spender, Pambianco Magazine, 12, 2012.

[93] Pambianco, *i Top Spender*. *Investimenti pubblicitari dei brand moda & lusso sulla stampa italiana 2011*, April 2012.

Table 2.2 Advertising investments for global style and luxury brands into Italian press in 2011 (euros)

Brand	2011	2010	Var. %
Prada	19,963,060	10,841,315	84.1
Peuterey	9,809,343	11,429,380	-14.2
Chanel	8,116,665	5,785,143	40.3
Dolce & Gabbana	8,029,075	6,316,613	27.1
Gucci	7,674,825	5,761,083	33.2
Giorgio Armani	7,253,720	4,235,100	71.3
Miu Miu	7,018,563	2,300,643	205.1
Tod's	6,553,225	5,946,893	10.2
Hogan	6,488,185	5,540,148	17.1
Louis Vuitton	6,347,000	5,271,958	20.4
Dior	6,302,958	6,086,913	3.5
Bulgari	5,376,410	3,455,693	55.6
Salvatore Ferragamo	4,911,985	2,374,868	106.8
Cartier	4,460,238	4,102,290	8.7
Fay	4,263,933	3,834,573	11.2
Valentino	3,263,165	1,689,003	93.2
Moncler	3,218,363	3,309,343	-2.7
Ralph Lauren	3,203,443	3,038,225	5.4
Rolex	3,122,085	3,397,020	-8.1
Versace	3,083,688	3,389,763	-9.0
Emporio Armani	3,029,438	2,122,613	42.7
Fendi	2,953,630	1,551,788	90.3
Hermès	2,686,835	3,072,738	-12.6
Patek Philippe	2,683,365	1,000,951	168.1

Source: Pambianco, Strategie d'impresa, April 2012

Prada is the top spender, with an investment of 19.9 million euros, also due to its listing on the Hong Kong Stock Exchange. It is followed by Chanel, with 8.1 million euros, and Dolce & Gabbana, with 8 million euros. Considering the investments for each group (adding brand investments within the same group), Prada Group is confirmed to be at the top (with 26.9 million euros), followed by LVMH Group (20.9 million euros), Tod's Group (13 million euros) and Giorgio Armani (10.2 million euros).

The following table illustrates advertising investments for each sector (Table 2.3).

Table 2.3 Global fashion and luxury brands' investments for each sector into Italian press in 2011 (euros)

Brand	2011	%	2010	%	Var. %
Sportswear	178,160,375	25.3	170,705,100	26.6	4.4
Women's wear	92,999,900	13.2	84,727,425	13.2	9.8
Footwear	78,745,578	11.2	68,868,555	10.8	14.3
Leather goods	74,824,323	10.6	55,674,008	8.7	34.4
Watches	69,951,175	10.0	67,459,800	10.3	3.7
Perfume	54,422,038	7.7	45,259,623	7.1	20.2
Jewellery	42,179,550	6.0	35,414,625	5.5	19.1
Men's wear	32,451,825	4.6	26,602,675	4.2	22.0
Underwear, Beachwear and Socks	29,845,264	4.2	35,894,787	5.6	-16.9
Eyewear	23,002,020	3.3	22,716,355	3.5	1.3
Children'wear and footwear	20,606,415	2.9	19,030,028	3.0	8.3
Others	5,700,840	0.8	8,280,636	1.3	-31.2

Source: Pambianco, Strategie d'impresa, April 2012

Sportswear is the sector with the most investment (25.3% of the total investment, an increase of 4.4% compared to the previous year). Women's wear is in second position (13.2% of the total investment, an increase of about 10%), followed by footwear (11.2%), leather goods (10.6%), watches (10%), perfume (7.7%) and jewellery (6%).

The following table illustrates advertising investments for printed

publications in Italian press in 2011 (Table 2.4).

Table 2.4 Global fashion and luxury brands' advertising investments for printed publications in Italian press in 2011

Typology	Market share 2011 in %	Market share 2010 in %
Weekly Newspapers	47.0	49.0
Monthly Magazines	31.0	28.0
Daily Newspapers	22.0	23.0

Source: Pambianco, Strategie d'impresa, April 2012

As for publications, weekly newspapers accounted for 47% of the total investment, followed by daily newspapers (31%) and monthly magazines (22%).

2.2.4 Place

The distribution represents a fundamental moment of the relationship between a luxury company and its customers. In the luxury sector, the idea is to know how to sell someone, even before knowing to sell something[94]: an almost direct relationship must be established with the customer, exalting their aspirations and stressing the product's exclusiveness.

The point of sale becomes the place where the customer meets the company; in particular, the course of developing this contact can be observed in different moments:

a) initial moment: this includes both the external impact of the point of sale and the entry. The sales channel represents the place where a brand expresses itself and where the customer can satisfy their dream. The point of sale contains the featured elements of a brand[95]. This generates a strong emotion[96]

[94] Kapferer J.N., Bastien V., *Luxury Strategy*, cit., p. 241.

[95] Ceriani G., *Il marketing moving: l'approccio semiotico*, Franco Angeli, Milano, 2001, p. 35.

[96] Holbrook M. B., Hirschman E.C., "The experiential aspects of consumption: consumer fantasies, feelings, and fun", *Journal of Consumer Research*, 9(2), 1982, pp. 32 ff. Huang

and requires the involvement of the customer. The point of sale often takes the semblance of a consumption cathedral[97], set in strategic places that are really attractive and important; this explains the attitude of companies to set points of sale in the so-called *first-tier cities circuit*, involving the cities of Milan, New York, Tokyo and London, in order to strengthen their brand image. For example, Prada Epicenter, Prada's space created in various metropolises, like New York and Los Angeles, has become an experience catalyst, among which shopping is just one of the pulsating elements.

When luxury goods must exalt the exclusiveness of a collection and brand, the point of sale is studied in every detail, almost to recreate a dream environment with the purpose of creating a loyal relationship with customers[98]. The first Tom Ford point of sale opened in 2007 in Madison Avenue for the haute couture men's collection is an example. Its creator's logic was to realise a *very luxurious, very chic* environment, inspired to be like a private residence but offering every kind of service: personal vendors, butlers, seamstresses, waiters and pattern makers.

The choice of location is really significant, since the point of sale must be set in the most important shopping streets or crucial points of a place. Even the position along the street is important, for it must guarantee the brand full visibility. Milan boutiques into the fashion street (Via Montenapoleone, Via della Spia, Via Sant'Andrea), rather than the London ones in Bond Street are good examples.

In a city, a company often chooses to create different locations for the same brand, whether alternative or complementary[99], with the purpose of pursuing both customer differentiation and location accessibility. For instance, in Milan, Louis Vuitton has chosen three locations: the Galleria, via Montenapoleone and La Rinascente. Tourists mainly frequent the Galleria and via Montenapoleone stores, while residents go to La Rinascente and via Montenapoleone stores. Social class has also been considered: the super-rich

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M.H. "The theory of emotions in marketing", *Journal of Business and Psychology*, 16(2), 2001, pp. 239 ff.

[97] Ritzer G., *La religione dei consumi. Cattedrali, pellegrinaggi e riti dell'iperconsumismo,* Il Mulino, Bologna, 2000, pp. 101 ff.

[98] Cheng Y.S., Chi L.H., "Salespersons' service quality and customer loyalty in fashion chain stores: A study in Hong Kong retail stores", *Journal of Fashion Marketing and Management,* 13(1), 2009, pp. 98 ff. Wang C.H., Ha S., "Store attributes influencing relationship marketing: a study of department stores", *Journal of Fashion Marketing and Management*, 15(3), 2011, pp. 326 ff.

[99] Corbellini E., Saviolo S., *L'esperienza del lusso*, cit., p. 161.

are more attracted by the Galleria and via Montenapoleone, while the middle class are attracted by the Galleria.

When a customer enters a point of sale, the first impact is its design and the shop assistant's courtesy and professionalism; a regular customer must receive preferential treatment and a potential customer must have the opportunity to belong to the brand sphere; and

b) the crucial moment of contact with the product: this makes a shop assistant's activity significant. The sales staff must be strongly motivated and trained to interact both with exclusive customers and occasional ones, reserving at the same time an affable attitude even though with necessary differentiation. The interaction with heterogeneous customers requires the employment of different messages and languages[100], so that the contact with the product takes upon an experiential dimension.

Offering a commission on sales could be a wrong decision; in fact, the shop assistant's objective is to convey a brand and allow the satisfaction of a dream. A commission would lead the shop assistant to conduct aggressive interactions with customers, which goes against the logic of the luxury sector. Customers must be given time to reflect on their next purchase. The good work of a shop assistant is often demonstrated by the customer (convinced of a purchase) coming back after a few hours, at the end of their shopping tour. On the one hand, a shop assistant must convince the customer to make the purchase; on the other hand, the latter must feel that they are the protagonist of the relationship. Thus, the shop assistant is like a "master of ceremonies"[101], exalting the brand's heritage, the intrinsic value of the product and all relevant details. Price becomes a non-relevant factor instead, becoming only a method for them to become owners of a product or consumers of a service. This should already be in a good shop assistant's narrative, just like a painter showing his pictures, so that customers can come into contact with that sphere and perceive its images, reliability, comfort and scents.

The distribution network and the point of sale remarkably influence the constitution of brand identity, due to how a product is presented and its availability in the market[102]. Luxury products are mostly commercialised in a highly selective manner, privileging mono-brand boutiques and boutiques or shops in specialised corners, set in the centre of big cities, in exclusive

[100] Ciappei C., Surchi M., *Il lusso nel dettaglio*, cit., p. 117 ff.

[101] Corbellini E., Saviolo S., *L'esperienza del lusso*, cit., p. 162.

[102] Saviolo S., Testa S., *Le aziende del sistema moda*, cit., p. 240. Giacosa E., L'economia delle aziende di abbigliamento, cit., pp. 343 ff.

touristic places or international airports. Companies such as Louis Vuitton and Hermès, commercialising their goods only in their own shops, carry out systematic control of their distribution system. Chanel has chosen mono-brand boutiques and distinct corners in prestigious boutiques; other companies, such as Armani, Gucci and Prada, ground their distribution systems both in their own shops and in carefully selected boutiques.

The distribution of luxury products can be selective or exclusive. Selective distribution occurs with a limited number of opportunely selected points of sale, favouring a service with high customisation for customers and providing benefit to the brand image. Competition is based on quality. Distribution selectivity represents an obstacle for the customer regarding provisioning; only being able to find the product in certain places or cities makes the customer's perception of desire achievement upon purchasing higher. The availability obstacle is often perceived as economic (depending on available wealth) or temporal (depending on waiting time for the product). Time is a necessary factor strengthening selectivity and it is considered a key dimension[103] of luxury: temporal wait length feeds desire and makes the product even more exclusive. Sometimes the distribution of luxury products is exclusive: that is, the company chooses to commercialise the product through a limited number of resellers with reference to a geographical area, who employ highly qualified staff and offer a particular post-sales service. The purpose is to convey the exclusivity of the product, besides carrying out strong control of the distribution system.

A luxury point of sale is considered to be a value creation source: it either has a predominantly distributive value, like for Escada, or both a distributive and handcrafted value, like for Louis Vuitton, with the opportunity of ordering a unique customised piece. The choice between a selective or exclusive system depends not only on price but also on other variables of the marketing mix. In particular, an exclusive distribution system is necessary for products with high prices and important post-sales services. In addition, promotional activity is quite intense and targeted and the product image represents a luxurious and extremely exclusive product. Distribution choice can be remarkably expensive, since setting a point of sale in exclusive, stylish streets requires considerable expense, so many luxury companies prefer a property investment rather than a lease.

Distribution effectiveness also depends on a good communicative policy applied to the point of sale: it must be a luxury worshipping place that is suitable to consolidate the attachment of historical customers. It must also

[103] Kapferer J.N., Bastien V., *Luxury Strategy*, cit., p. 93.

attract the attention of new customers. Inside, the window is the brand mirror, representing a stage where the main products are shown and the company can express each of its brand dimensions. The point of sale, e.g. a boutique or a car dealer, must satisfy customer perception in a visual, tactile, olfactory and auditory sense. This has led to the birth of *concept stores*: commercial spaces exposing the product in a scenographic manner to make shopping unique.

From a mono-brand or multi-brand point of view, the sale of an object is associated with the creation of a lasting and emotional relationship with customers; the aim is not the occasional sale but customer retention. Thanks to a multi-sensorial communication policy[104], the customer finds an environment where they are not obliged to buy. On the contrary, this place gives them the time and space to convince themselves to buy[105]. An example of this is Armani's megastore in Milan, in Manzoni Street.

The fundamental role of the point of sale has led to the creation of *flagship stores*: points of sale set in famous locations in the most prestigious cities[106], as via Montenapoleone in Milan, via Condotti in Rome, rue Faubourg St. Honoré in Paris, Ginza quarter in Tokyo, Bond Street in London, etc. A flagship store often has a limited dimension, with a restricted commercial offer or even with products only on display and not for sale. This is justified by the fact that their main objective is not turnover but brand visibility development.

[104] Clarke D.W., Perry P., Denson H., "The sensory retail environment of small fashion boutiques", *Journal of Fashion Marketing and Management*, 6(4), 2012, pp. 492 ff.

[105] Saviolo S., Testa S., *Le aziende del sistema moda*, cit., p. 247.

[106] Bruce M., Hines T., *Fashion Marketing. Contemporary Issues*, cit., p. 278 ff.

3
Trends in the Luxury Business

3.1 Growth Drivers in the Luxury Business

The luxury phenomenon has boomed during the twentieth century. The main drivers of this growth can be identified with the following:

a) the luxury "democratization" phenomenon[1]: from non-affordable phenomenon, luxury has expanded into intermediate and affordable luxury segments. This has led to a less marked social stratification, allowing for a wider range of customers to purchase luxury products;

b) increase in customer purchasing power: the increase in the purchasing power of potential customers has generated wealth to be spent on shopping and therefore on luxury products. In my opinion, besides an increased purchasing power, also the social wealth of a population segment (the old rich and the new rich) has promoted luxury products consumption, given the greater amount of time available for lucrative and relax activities in daily life. This has favoured consumption of a wider range of luxury products, in particular those referring to the individual and to leisure: holidays, boats, private aircrafts, wellness, dinners at the restaurant and, consequently, the suitable look for every occasion are good instances;

c) market globalisation: globalisation allows for wider production ranges, thereby creating new desires in the customer's mind thanks to a "novelty effect". For instance, Japanese fashion luxury products, previously not very well-known, have been penetrating European markets and becoming competitors of Made in Italy products. A luxury brand should be recognizable in each country while having worldwide customers. Moreover, globalisation has caused migrations for business or personal reasons, which also translates into shopping desire moving from one continent to the other. Wealthy individuals might create new consumption trends in a country, which would add to the shopping habits of the resident population. This leads to an increase in the total consumption of luxury of that country, which in turn translates into

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[1] Thomas D., *Deluxe. Come i grandi marchi hanno spento il lusso*, DeAgostini, Novara, 2007, pp. 245 ff.

advantages for the companies that sell their products there;

d) country of origin: luxury companies, especially non-affordable luxury businesses, tend to manufacture their products in places that are "legitimated" to manufacture luxury products. In other words, luxury products should be manufactured in a country that fits in the luxury universe, i.e. where the product is so rooted as to further legitimate its exclusiveness. Such place represents the temple where the brand myth is created and its worship exalted[2]. If France is Chanel and Dior's legitimizing country, the same does not apply to brands that outsource their manufacturing process (or part of it) in countries where labour costs are low.

Globalization has generated negative effects on luxury "pureness" by moving production to such countries. Transferring the manufacturing process (or part of it) has caused brand image to decline. If "Made in" has to be a guarantee of a product intrinsic quality, a product made in China (as stated on its label) loses that quality status that all luxury products must have. This is true for every product typology, not only for garments. For instance, in the automotive industry, BMW has strongly expressed the intention of manufacturing the Mini in the United Kingdom, as well as Rolls-Royce has decided not to outsource. When Burberry declared their intention to close a factory in the United Kingdom, both workers and customers strongly protested.

The decision not to outsource production allows a closer contact between the creative and productive phases, which enhances the creative and functional aspects of products. French haute couture, for instance, started to decline when manufacturing was outsourced in foreign countries. Any company that decides to outsource should be well aware of the risks related to a loss of luxury status;

e) the commercial strategies of luxury companies: investments on advertising luxury products have increased the desire of owning luxury items. Communicative messages has become a means to engage the customer in a sort of parallel unreal world, where an object feeds the myths of beauty and perfection. On the one hand, this has strengthened customers' faith in the good quality of products and in the rightness of purchases; on the other hand, it has expanded the reference target.

Moreover, communication has favoured knowledge of a wider offer, which has translated into the creation of new desires. A successful communicative message should trigger a "non-return" effect in the customer's mind, i.e.

[2] Kapferer J.N., Bastien V., *Luxury Strategy*, FrancoAngeli, Milano, 2009, p. 219. Corbellini E., Saviolo S., *Managing Fashion and Luxury Companies*, Etas, Milano, 2009, pp. 33 ff.

customers should feel the absolute necessity of owning a luxury product, once they have grown used to enjoy luxury. The effect is triggered when, although having fewer financial resources, customers tend to reduce traditional expenses (such as replacing a non-luxury car with a smaller non-luxury one) in order to be able to afford purchasing a much craved luxury product.

It follows that the success of a luxury product derives fundamentally from the effect of two combined elements: on the one hand, a product should guarantee social success, i.e. enable customers to show that they belong to a certain social class and that they are wealthy. In this sense, luxury guarantees brand status. On the other hand, it should stimulate the perception of extreme satisfaction, or it should generate pleasure.

3.2 Trends in the Luxury Market

The following table represents the trends in world luxury business from 2007 to 2011, followed by a three-year period forecast (Table 3.1).

Table 3.1 World luxury business

Years	Euro billion
2007	170
2008	167
2009	153
2010	173
2011	191
2012*	201-203
2013*	216-218
2014*	235-240

Source: Altagamma, Osservatorio Altagamma – scenario 2012, May 2012

In 2008 and 2009, the luxury business witnessed a global decline. Starting from a turnover of 170 billion euros in 2007, the world crisis caused a decrease in turnover both in 2008 (167 billion euros) and in 2009 (153 billion euros).

Starting from 2010, the luxury business has recovered and got back to pre-crisis levels of turnover. In 2010 the turnover was 172 billion euros with an increase of 12% compared to the previous year. Nearly all markets recovered, except Japan, and South-East Asia represented the driving market both in 2009 and in 2010. Also 2011 witnessed a consumption revival, with a turnover of 191 billion euros.

The expected world turnover for 2012 is 200 billion euros, i.e. 6-7% higher than 2011. Asian markets will be the driving ones: both local customers and Asian tourists who do some shopping while travelling. New markets in South America and Africa will also emerge. A further market growth is estimated also for the following two-year period, which proves that the luxury business looks promising in the medium term: for 2013 the expected turnover is between 216 and 218 billion euros (i.e. 7-8% growth rate), and about 235-240 billion euros in 2014 (i.e. 8-10% growth rate)[3].

The global financial crisis has influenced the luxury sector. Although the direct result has been a decline of consumption, the luxury market has recently begun a new growth phase. Luxury brands have shown a capability of increasing their appeal even towards day trippers, by improving attractiveness and desirability in various situations of everyday life[4].

Trends are represented by the following chart (Figure 3.1)

[3] All data related to the trends analysed are taken from Altagamma, *Osservatorio Altagamma – scenario 2012*, Milan, May 2012.

[4] Culasso F., Giacosa E., Mazzoleni A., “Fashion system: the case of Italy”, *World Journal of Social Sciences*, 2(3), 2012, pp. 209 ff.

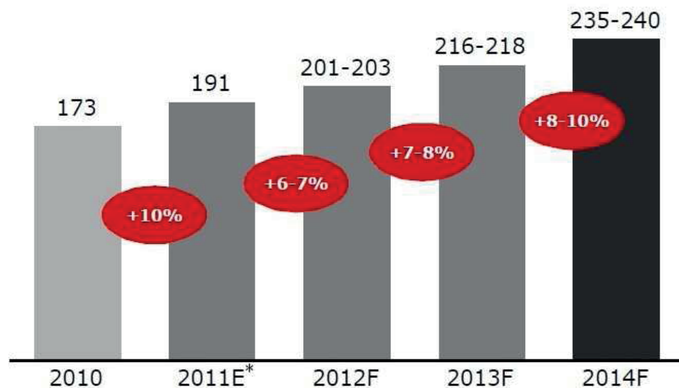

Figure 3.1 Worldwide personal luxury goods market evolution (Euro billion)

Source: Bain & Company, Altagamma Foundation, 2012

E= as shown in the latest financial statements of luxury companies*

F = forecast

The geographical origin of the global turnover of the luxury business is described below[5]. In 2012 the four main world markets (United States, Japan, Italy and France) have accounted for about half of the total turnover of luxury products. China drives the growth of the luxury business with a 18-22% growth rate compared to 2011: the Chinese market represents the 20% of world luxury consumption and more than 50% of the Asian market. China is followed by India (+ 15-20%), where many stores have been opened. India is followed by Brazil, Mexico and other South-East Asian countries. Mature markets, such as the Italian, Spanish and Japanese ones, have witnessed a decrease in the demand; on the contrary, other mature markets, especially Eastern European countries and the United States, have shown a significant consumption of luxury products, thanks to tourist flows and to increasing trends in luxury consumption in certain areas.

The forecast for 2017 is that China will be the second largest luxury market in the world, the first being the United States. The importance of the Chinese market derives from the increase in the number of wealthy people and of the middle class; in Europe, on the contrary, the decline of incomes and consumption will affect the luxury business. The importance of Brics countries (Brazil, Russia, India, China) is highlighted by the increase in luxury

[5] Altagamma, *Osservatorio Altagamma – scenario 2012*, cit.

consumption: in 2007, it represented 4% of the world market; in 2012 the percentage has gone up to 11% and for 2017 the forecast is of a growth rate of 16%[6].

The following table analyses the origin of the world turnover of the luxury business with reference to product categories (Table 3.2).

Table 3.2 Origin of world turnover for the main merchandise categories (2009-2012)

Geographical area	2009	2010 (versus 2009)	2011 (versus 2010)	2012 (versus 2011) (forecasts)
Apparel	27%	+8%	+10.0%	+6.5%
Perfumes and cosmetics	24%	+2%	+6.5%	+5.0%
Accessories (bags, shoes, eyewear, etc.)	24%	+16%	+12.5%	+10.0%
Jewels, watches and precious items	19%	+13%	+11.5%	+10.0%
Art de la table (plates, glasses, cutlery)	4%	+0%	+3.8%	+2.5%

Source: Altagamma, Osservatorio Altagamma – scenario 2012, May 2012

In 2011, accessories (leather accessories, jewels and watches) were the strongest driving category with a 12.5% growth rate. Jewels and watches also grew (+11.5%), followed by apparel (+10%). According to the forecasts for 2012, accessories, jewels and watches are the strongest driving categories with a 10% growth rate. Growth is expected to slow in apparel: compared to the 10% of 2011, the forecast for 2012 is only 6.5%.

The global financial crisis has affected consumption of luxury products. First, it has stimulated individual firmness and strictness in purchasing luxury goods: people tend to prefer products with a strong brand identity, which are perceived as more credible, and customized items, that are considered more functional. Secondly, it has made customers more clear-headed in their evaluations: they proves to be less yielding towards falsely innovative products and more oriented towards goods with a tangible benefits[7].

[6] Euromonitor International, 2012.

[7] Gandini C., Turinetto M., *Lusso necessario alla ricerca del valore per vincere la crisi*, Lupetti, Milano, 2009, p. 22. Curran L., Zignago S., “The financial crisis: impact on key cloth-

The big international groups have had the best performances in comparison with the global average; in this sense, strategies aimed at growing in the emerging markets have been successful. The following table analyses turnover and EBITDA trends of the main international groups between 2007 and 2010 (Table 3.3).

Table 3.3 Turnover and EBITDA trends of the main international groups (2007-2010)

Company	Turnover 2010 (Euro/billion)	Turnover var. (2007-2010)	EBITDA 2010 (% on 2010 turnover)	EBITDA var. (2007-2010)
LVMH	20.32	7.2%	25.1%	0.6%
Richemont	6.89	9.2%	24.4%	-0.1%
Luxottica	5.80	5.3%	17.8%	-3.6%
Ralph Lauren	4.29	7.5%	18.4%	-1.3%
Gucci Group	4.01	7.8%	26.3%	1.7%
Hermès	2.40	13.9%	32.0%	1.6%
Tiffany & Co.	2.34	3.3%	24.1%	1.9%
Prada	2.05	7.2%	26.2%	7.2%
Burberry	1.77	7.8%	24.2%	2.3%
Bulgari	1.07	-0.7%	14.6%	-4.7%
Tod's	0.81	6.4%	23.8%	1.0%
Average		7.2%	23.8%	0.4%

Source: PwC, Luxury Market Insight. Sfide ed opportunità nel mondo del lusso: winners e strategic drivers, 2011

Considering the main international groups operating in the luxury business, the chart highlights that the average turnover growth between 2007 and 2010 was 7,2%. Hermès had the highest increase in turnover (+13.9%), followed by Richemont (+9.2%). Other important brands operating in the fashion sector were successful, among which Gucci Group (7.8%), Burberry (7.8%), Ralph Lauren (7.5%), LVMH (7.2%) and Prada (7.2%). Comparing the turnovers of

ing markets and suppliers", *Journal of Fashion Marketing and Management*, 14(4), 2010, pp. 530 ff.

Italian and foreign groups, the latter have larger turnovers: on average, foreign companies are five times bigger than Italian ones and, in general, their growth is faster thanks to M&As.

As for EBITDA, Prada had the best performance (with a growth of 7.2%); other groups obtained positive performances even though inferior to Prada: Burberry, Gucci Group, Hermès, Tiffany & Co. and Tod's. LVMH registered a moderate increase in EBITDA. The others all had negative performances.

Luxury companies have recourse to the most innovative communication means in order to explore new forms of interaction with the market: Gucci and Louis Vuitton have resorted to social media and Burberry has used its web site not only to promote its products but also to keep in touch with its customers. Another important driver of growth is the strong customization adopted by non-affordable luxury, that aims at complete customer satisfaction, even by anticipating and generating needs[8].

Digital tools are more and more used in the luxury business in order to meet new customer needs. In the last few years, luxury players have invested resources to develop on-line single-brand stores; besides, on-line multi-brand stores have been created to sell both products at full price and discounted products, also through on-line auctions. In particular, web sites selling products at full price account for 50% of the total on-line turnover, and witnessed an increase of 28% in 2011 compared to the previous year.

For the next ten years the forecast is that the digital market of luxury products will witness a growth as strong as that of the Asian and South American markets. In 2011 the on-line market grew by 20% and the turnover deriving from on-line sales of luxury products was 4.5 billion euros (2.6% of the total turnover): the forecast for 2015 is an increase up to 11 billion euros. 2016 could be the year when China overtakes the United States as far as on-line purchases are concerned[9].

By 2015, more than 200 million European customers will buy fashion and luxury products on-line, thereby attracting about 40 million new customers compared to 2011. The United Kingdom, France and Germany are amongst the most receptive countries. Also in the United States web sites for fashion shopping are popular[10].

[8] Interbrand, *Best Global Brands 2011*, 2012, p. 51.

[9] Digital Luxury Experience™ - Altagamma Observatory, 2011. The study has been carried out on a sample of 187 companies working in the luxury business, whose total turnover amounts to 60 billion euros.

[10] Digital Luxury Experience™ - Altagamma Observatory, 2011.

In Italy, on-line sales in 2011 increased by 19% compared to 2010, and the forecast for 2012 is an increase of 18%. Apparel is the strongest merchandise category, since in 2011 it represented 10% of the total on-line sales (with an increase of 38% compared to 2010), and the growth forecast for 2012 is of 30%. In the last two years, nearly all fashion companies have opened an on-line sales web site: some have been using Yoox, others have created a dedicated e-commerce section on their own web sites. Even though revenues deriving from on-line sales do not account for more than 2-3% of a company's total revenues, investments on e-commerce are being intensified, since they result in higher visibility especially on foreign markets. More and more dynamic web-sites are being created, so that they are more involving and appealing to potential customers. The use of digital tools in fashion and luxury is encouraged by the fact that more and more customers do their shopping on smartphones and tablets. The presence of Italian e-commerce companies on Facebook, YouTube, Twitter and Google+ is of 72.1% and 59% of them use social media to reach their target market (especially Facebook). In 2011, mobile commerce increased by 210% compared to 2010 (about 1% of the turnover of on-line sales)[11].

On-line channels are also used by customers to form an opinion or find information with a view of off-line purchases of luxury products. 70% of European customers (50% of American customers and 63% of Chinese customers) have stated that they surf the Internet in order to find out information about a product before buying it in a traditional shop. The close relationship between traditional and digital sale channels works also in the opposite sense: 70% of web sales in Europe (59% both in the United States and in China) derive from a purchase evaluation made in a traditional store. Moreover, 56% of European customers (46% of American shoppers and a good 78% of Chinese consumers) prefer on-line purchases to create a direct relationship with the brand[12].

Brand status is a highly relevant factor in the digital economy era, since the opportunity to exchange opinions on purchasing experiences is strongly intensified. This is also favoured by brand visibility: companies operating on the web which have created a Facebook page, for instance, in 2011 have increased their number of "friends" by 136% compared to the previous year. Customer persuasion originates in 68% of cases in the use of the official web-site of the brand, which is preferred since it gives the opportunity to obtain true and detailed information. Fashion blogs represent another important means: Chinese customers are the most attracted (58% of Chinese customers compared to 27%

[11] www.pambianconews.it, June 2012.

[12] Digital Luxury Experience™ - Altagamma Observatory, 2011.

of European and American shoppers), with the purpose to quickly learn new Western styles and adapt their look. Customers might also refer to specialized magazines to form an opinion (50%)[13].

Coupon web-sites are another important aspect of luxury e-commerce. These sites perform a function of intermediation between the buyer and the seller. Coupon sites works on the basis of the following principles:

a) as far as the demand is concerned: the great number of sellers participating to the purchasing group allows for reductions in purchasing prices; the closeness of the seller to the purchaser reduces freight costs and, consequently, purchasing prices; sites offer additional services, such as socialization opportunities. Participants can share ideas and experiences directly on the web-site or through social networks;

b) as for the offer: a shorter distribution chain increases opportunities of applying higher sale prices, without affecting customers; the manufacturer can exploit a new promotional means.

The following chart quantifies the coupon sites phenomenon in the United States, where it was originally launched, and in Europe.

On-line coupon sites originated in the United States and the main international players are American: Groupon, the pioneer in this field, also operates in Europe, and Living Social is mainly known in the United States. Comparing Groupon and Living Social visitor trends (from August 2009 to April 2011), the number of visitors has remarkably increased from March 2010, registering more than 10 million subscribers on Groupon and more than 8 million on Living Social. The increase in the number of subscribers compared to the previous year was 250% on Groupon and 82% on Living Social (Figure 3.2).

[13] Digital Luxury Experience™ - Altagamma Observatory, 2011.

Figure 3.2 Trends in Unique Visitors (000) to Groupon.com and LivingSocial.com (August 2009-April 2011)

Source: ComScore Media Metrix.

The European market has greatly appreciated coupon sites. In 2010 visitors were 34.9 million, with an increase of 162% compared to 2009. Groupon, which entered the market in 2010, has been driving growth in Europe, representing 35% of the total number of European visitors (Figure 3.3).

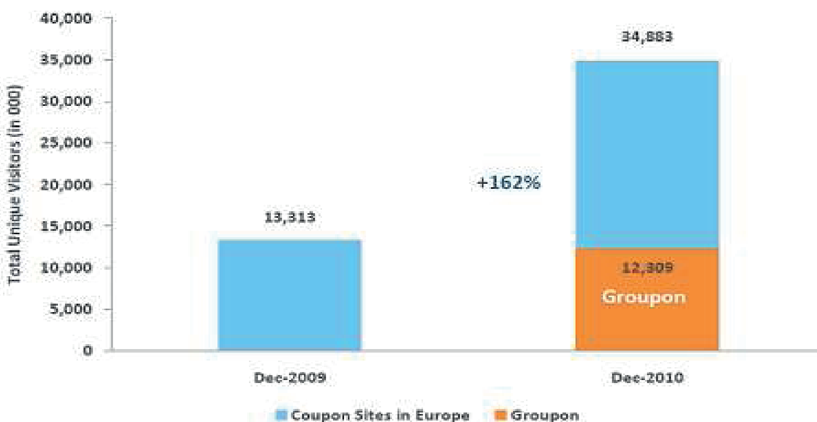

Figure 3.3 Growth of Coupon Sites in Europe by Total Unique Visitors (000)

Source: ComScore Media Metrix.

European market is quite heterogeneous about users of coupon sites. France has witnessed the greatest market penetration, followed by the United Kingdom and Italy (Table 3.4).

Table 3.4 Reach of coupon sites in EU countries with highest penetration (December 2009-December 2010)

Countries	% of coupon sites users on the total of internet users	% growth (versus 2009)
France	20.6	6.7
United Kingdom	17.0	6.1
Italy	15.2	15.0
Turkey	13.9	13.6
Germany	11.1	7.8
Poland	11.1	N/A
Spain	8.9	8.0
Belgium	8.0	4.0
The Netherlands	7.3	1.6
Portugal	6.2	5.8
Europe	9.6	5.7

Source: ComScore Media Metrix

E-commerce sites often work on the basis of temporary sales, thus becoming flash sale sites. Products are sold at a discounted price for a fixed period of time; generally, the most recurring merchandise categories are apparel and accessories. The objective is to sell-off unsold stocks by creating a sort of event around the sale, that is advertised some days before and occurs only at certain times during the year. Moreover, in order to loyalize consumers, only subscribers who are registered on the site are allowed to make purchases.

Flash sale sites are popular in the United States, where the leader companies are Gilt Groupe, Haute Look and Ideeli. In particular, in 2010 Gilt Groupe increased the number of customers by 52% compared to 2009 (Table 3.5).

Table 3.5 Single visits (000) of the main Flash Sale Sites in 2010

Flash Sale Site	Visitors (000)	2010 (versus 2009)
Gilt.com	863	+52%
Hautelook.com	793	+1%
Ideeli.com	658	+16%

Source: ComScore Media Metrix

3.3 Counterfeiting in the Luxury Business

The luxury business is significantly affected by counterfeit. “Counterfeiting” consists in the production of a product with intrinsic features and brand that are similar to the original product: to inexpert eyes, counterfeited products look like acceptable reproductions of the original. Some studies have defined counterfeiting as an endemic parasite[14] of luxury, whose phenomenon exploits both the functional and the dream attributes of a luxury product.

From a different point of view, counterfeiting can be considered as the price to be paid in return for success[15]. A brand is subjected to counterfeiting when it is well-known, craved for and recognizable on the market. When a brand is not counterfeited, it is probably not a luxury brand. This is true if the product lends itself to counterfeiting: cars, boats, helicopters, airplanes and other products cannot be counterfeited because of their features and functional character. Thus, counterfeiting might be considered as a signal for the appeal of a brand. However, brands that are counterfeited are also more exposed and tend to lose exclusiveness. Louis Vuitton provides a good example: some wealthy customers tend not to consider some of its products as luxury items, because of their overexposure. For instance, the Speedy bag is one of the most counterfeited items in the luxury business.

Counterfeiting involves different subjects: on the one hand, the manufacturers of counterfeited products; on the other hand, the customers who buy them. As far as customers are concerned, it is possible to make the following distinction:

a) individuals who purchase a counterfeited product to feel part of a social group. They do so because they cannot afford original products, or because

[14] Kapferer J.N., Bastien V., *Luxury Strategy*, cit., p. 172.

[15] Thomas D., *Deluxe*. *Come i grandi marchi hanno spento il lusso*, cit., pp. 279 ff.

they do not consider the price in line with the intrinsic value of the luxury product, or because they believe that nobody will recognize their purchase as a counterfeited item. These people are potential customers of the brand, since they are attracted by its fame: therefore, companies must encourage their craving through marketing policies which target this segment as well. Also people who are satisfied with purchasing counterfeited bags, even though they crave for the original, represent potential customers in case they become wealthier. Or customers who could afford to purchase an original luxury item but are satisfied with obtaining an almost perfectly counterfeited product. Such kind of counterfeiting affects the brand, since it generates brand overexposure, and consequently a decrease in its desirability [16]. Moreover, counterfeiting might pose a threat for customer safety, since counterfeited products are often manufactured with materials and through processes that do not comply with existing laws and regulations;

b) individuals who are being deceived into purchasing items that they think of as original. In such case, companies must tighten controls on retailing channels.

On the one hand, counterfeiting signals that customers crave for certain brands; on the other hand, it signals companies that they should closely monitor their manufacturing and commercial policies[17]. As far as manufacturing is concerned, if companies outsource, risks of counterfeiting are obvious: suppliers might manufacture a higher number of pieces than ordered, and sell them on parallel markets. In this case, the brand is affected. On the contrary, when products show poorer quality and different functional features than the original, both brand and customers are affected. Moreover, in case of licensing, the licensee might be tempted to apply the brand also to products not provided for in the contract or, even to market poorer quality products. As far as commercial policies are concerned, counterfeiting could be a consequence of excessively strict retailing policies, which make it extremely difficult for potential customers to purchase products in a brand store. However, no counterfeiting at all might signal lack of desire towards a certain product, which in turn indicates the inopportunity of opening of a new store. On the contrary, retailing might be not sufficiently selective and, therefore, difficult to monitor.

Counterfeiting should be distinguished from imitation. A product is an imitation if its name, brand style and/or colour are similar to those of a famous

[16] Cappellari R., *Il marketing della moda e del lusso*, Carocci Editore, Roma, 2008, p. 63.

[17] Kapferer J.N., Bastien V., *Luxury Strategy*, cit., pp. 174 ff.

brand, such as B&G jeans (imitations of D&G jeans) and Nice shoes (imitation of Nike shoes). These are sold on markets, beaches and in the streets[18].

The fashion industry is highly affected by counterfeiting. Counterfeited products are mainly manufactured in China (72.95%), followed by Hong Kong (7.67%), Greece (4.79%), India (3.29%), Saudi Arabia (2.80%) (Figure 3.4).

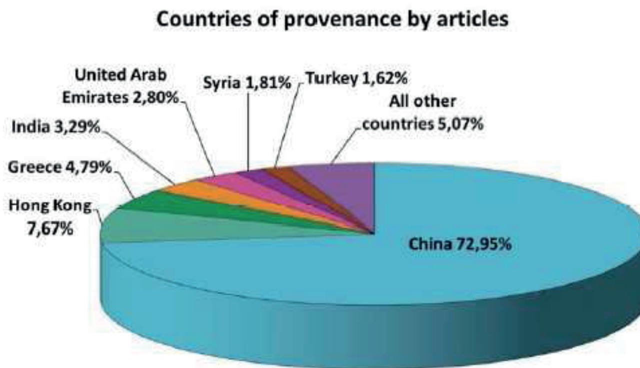

Figure 3.4 Country of origin of counterfeited objects

Source: Report on EU customs enforcement of intellectual property rights, 2011

The most counterfeited luxury products are accessories (38.6%), because of their high demand and desirability, and apparel (17.5%), followed by footwear (12.3%), watches and jewels (8.9%). The most counterfeited brands are Louis Vuitton, Gucci and Burberry[19].

The quantification of the phenomenon is obviously difficult, due to its illegal nature and global diffusion; in addition, illegal traffic in counterfeited products is not thoroughly traceable. It has been estimated that Made in Italy luxury brands sustain yearly losses of 12 billion euros due to counterfeiting, together with job losses of 20 thousand units[20]. Counterfeiting accounts for 8% of world trade[21] with an estimated job losses about 130,000 units. In Italy, from 2008 to 2011, 71,000 confiscations of counterfeited goods were per-

[18] Giacosa E., *L'economia delle aziende di abbigliamento*, Giappichelli, Torino, 2011, p. 95.

[19] Report on EU customs enforcement of intellectual property rights, 2011

[20] Camera di Commercio di Monza e Brianza, March 2010.

[21] World Trade Organization, 2009.

formed, for a total of 228 million pieces confiscated and an estimated value of more than 2.2 billion euros. Compared to 2008, the number of confiscated items has increased by 30%[22].

[22] Ministero dello Sviluppo Economico, Dipartimento per l'Impresa e l'internazionalizzazione, *La contraffazione in cifre: la lotta alla contraffazione in Italia nel quadriennio 2008-2011*, Roma, 2012.

4
Company Growth

4.1 The Growth of the Company

A company might be seen as a "system"[1] or a homogeneous entity, based on the direct or indirect relations among its components[2].

Such a system encompasses a human and a material element. The former is represented by the individuals or group of individuals who work within a mutual relationship[3]: their work is paid for with a salary. The human element is crucial in luxury companies, as it contributes inspiration, creativity and attitudes. In addition, it plays a key role in terms of innovation, which is of the essence in this context. For instance, the engineer who designs new car models and the designer who creates a new collection are both key figures in determining their company's success or failure. The material element is represented by the means of production together with the financial capital[4].

It is thanks to the interrelations between these two complementary elements that business takes place[5]: the human element provides labour; the material element is crucial for the company to function. It follows that such elements are inseparable and that companies are holistic systems[6]. Considered as a system, a business has features that differ from those of the single parts

[1] Ferrero G., *Impresa e management*, Giuffré, Milano, 1987, p. 5. This part concerning the definition and the characteristics of "company system" is taken and elaborated from Giacosa E., *L'economia delle aziende di abbigliamento*, Giappichelli, Torino, 2011, pp. 30 ff. We refer only to Italian studies, focusing on the company as a system.

[2] Saraceno P., *La produzione industriale*, L.U.E., Venezia, 1970, p. 59.

[3] Ferraris Franceschi R., *L'azienda: forme, aspetti, caratteri e criteri discriminanti*, Edizioni Kappa, Roma, 1995, p. 21.

[4] Besides the human and material factors, which are easily recognisable, the organisational factor also contributes to this system. This can be defined as the way through which the human element dynamically combines with the material one. Caramiello C., *L'azienda. Operazioni di gestione e "dinamica dei valori"*, Giuffré, Milano, 1989, p. 35.

[5] Ferrero G., *Impresa e management*, cit., p. 6.

[6] Melis G., *Elementi di Economia Aziendale,* Giuffré, Milano, 2001, p. 35.

comprising it[7]; such elements[8] cannot be disjointed, and each business can be identified through the relationships established among them[9]. Any change occurring to any one component impacts on the others[10] and the very existence of a company depends on coordination among the elements[11]. These components are diverse but also complementary, interrelated and interdependent: as such, they make each company system unique[12].

Furthermore, each company is complementary to the market system, which in turn influences business. Consequently, although each company does maintain its economic autonomy[13], it cannot operate or survive by itself. On the contrary, it consistently interacts with its context through various relations.

In addition, no company is self-sustained and this explains the fact that all businesses have to interact with their context in order to gain or maintain a competitive advantage, share resources and acquire knowledge in order to reach a common goal[14]. The choice of cooperating or teaming up with other businesses is an opportunity in terms of economic advantage[15]. Since each company interacts with its context, this can be described as an "open" system[16]. On the contrary, in closed systems[17], the relations among the components are defined and developed within certain boundaries. More precisely, if a company tends to be influenced only by the positive factors of its environment, or by factors that could be selected, it is a "selectively open" system[18]; its movement

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[7] Zappa G., *Il reddito d'impresa*, Giuffré, Milano, 1946, p. 13.

[8] Ferrero G., *Istituzioni di economia d'azienda,* Giuffré, Milano, 1968, p. 5 ff.

[9] Favotto F., *Economia aziendale*, McGraw-Hill, Milano, 2001, p. 4.

[10] Farneti G., *Economia d'Azienda*, Franco Angeli, Milano, 2007, p. 3.

[11] Viganò E., *L'economia aziendale e la ragioneria*, Cedam, Padova, 1996, p. 25.

[12] Zappa G., *Il reddito d'impresa*, cit., p. 12. Onida P., *Economia d'azienda*, Utet, Torino, 1971, p. 4.

[13] Ferrero G., *Istituzioni di economia d'azienda,* cit., pp. 8 ff.

[14] Azzini L., Autonomia e collaborazione tra le aziende, Giuffré, Milano, 1974, p. 63.

[15] Del Baldo M., "Determinanti e condizioni delle strategie di "non crescita" delle piccole imprese", *Piccola Impresa/Small Business*, 3, 1997, p. 71.

[16] Farneti G., *Economia d'Azienda,* cit., p. 3.

[17] Vermiglio F., *Il bilancio sociale nel quadro evolutivo del sistema di impresa,* Grafo, Messina, 1984, p. 54

[18] Brusa L., *Strutture organizzative d'impresa*, Giuffrè, Milano, 1986, p. 2. Miolo Vitali P. (eds.), *Corso di Economia Aziendale,* Giappichelli, Torino, 2000, p. 24. Pavan A., *L'amministrazione economica delle aziende,* Giuffrè, Milano, 2008, p. 40.

towards the context would be relative, not absolute[19].

As an open system, each company establishes various relations with other companies or individuals: companies exchange products and services with consumers, and companies transfer money to employees in exchange for labour or to shareholders for capital. Other relationships take place between production companies in the supply of inputs to be used in the production process, etc.[20].

In addition to these, companies might establish other relations, with different strategies[21] and intensities, which fit into a sort of puzzle[22] within the eco-

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[19] Besides being open systems, companies are also characterised by the following, which actually make them companies (Giacosa E., *L'economia delle aziende di abbigliamento*, cit., pp. 32 ff.):

- social systems: companies are made up of groups of individuals who work together in order to reach certain economic objectives. Businesses can be seen as economic units created between humans and society (Ceccherelli A., *Economia Aziendale e amministrazione delle imprese,* Barbera, Firenze, 1948, p. 53. Beretta Zanoni A., *Strategia aziendale,* Cedam, Padova, 2008, p. 71). Therefore, companies are the means through which humans operate in the economy, and companies represent social institutions: they are created by individuals in order to reach human goals within a given community (Bertini U., *Il sistema d'azienda,* Giappichelli, Torino, 1990, p. 34). In performing such a social function (Ferraris Franceschi R., *Finalità dell'azienda e condizioni di funzionamento,* Seu, Pisa, 1984, p. 231. Cricchio S., *Il sistema informativo del bilancio di esercizio,* Giuffré, Milano, 1997, p. 17), companies mirror the cognitive processes of the individuals who created them;

- teleological systems: since companies are the means through which humans operate in the economy, they do not have their own goals. They actually aim at satisfying human needs;

- economic systems: any companies uses economic goods available in limited quantities. Consequently, the management has to prioritise their use. Such a process is informed by the principle of rationality (Pastore A., *La funzionalità economica dell'impresa*, Cacucci, Bari, 1984, p. 23); and

- dynamic systems: companies have to detect the ever-changing stimuli coming from the contexts surrounding them. They have to respond to such stimuli in a flexible way; they must seize opportunities, handle restrictions and adapt to the conditions of such an environment in a dynamic way. Dynamism is crucial to reach a position of dynamic balance, without which companies cannot last long. The attitude to consistently exist in mutability (Zappa G., *Il reddito d'impresa*, cit., p. 12. Onida P., *Economia d'azienda*, cit., p. 4) enables the system to last a long time, despite the fact that internal and external conditions might change.

[20] Amaduzzi A., *L'azienda nel suo sistema e nell'ordine delle sue rilevazioni*, Utet, Torino, 1978. Di Cagno N., Adamo S., Giaccari F., *Lezioni di economia aziendale*, Cacucci, Bari, 2002.

[21] Besta F., *La Ragioneria*, Valuardi, Milano, Vol. I, 1909, p. 158.

nomic context. Such relations are aimed at finding new and better conditions in terms of[23]:

a) growth: defined as the increase in company size, which can be assessed through quantitative elements (turnover, added value, staff, investments, market share, etc.)[24]. Consequently, growth is achieved whenever size increases in a given period of time. Growth is intrinsic to companies inasmuch as the element of challenge pertains to individuals, who transfer it to the companies that they manage[25]. The goal represented by growth might be related to both internal factors (stimulated by the management) and external elements (opportunities provided by the context in which the company operates[26]); and

b) development: this might be seen as a qualitative improvement in the business. In other words, development occurs when company size achieves a qualitative improvement thanks to better perspectives of economic and financial balance in the long term, after having gained a clear competitive advantage. Therefore, development is aimed at creating perspectives of stable profitability, which is related to the acquisition of new skills or to the creation of valid synergies among the elements that comprise the company.

Although growth and development often occur together, they are not mutually necessary. In other words, growth is not sufficient to guarantee development. An increase in size might not be necessary in order to stimulate development, at least from a theoretical perspective[27]. Nevertheless, the qualitative con-

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[22] Fazzini M., *Aggregazioni, accordi e alleanze tra imprese,* Franco Angeli, Milano, 2006, p. 5 ff.

[23] Cortesi A., *La crescita delle piccole imprese*, Giappichelli, Torino, 2004, pp. 50 ff. The terms "growth" and "development" are often used as synonyms when referring to the size of companies. Nevertheless, it is useful to distinguish them. Corticelli R., *La crescita dell'azienda*. *Ordine ed equilibrio nell'unità produttiva,* Giuffré, Milano, 1998, pp. 182 ff.

[24] Hart P., Mellons J., "Management youth and company growth: a correlation?", *Management Decision*, 4 (1), 1970, pp. 50 ff. Goold M., "The growth imperative", *Long Range Planning*, 32 (1), 1999, pp. 127 ff. Canals J., "How to think about corporate growth?", *European Management Journal*, 19 (6), 2001, pp. 587 ff.

[25] Conca V., *Le acquisizioni*, Egea, Milano, 2010, p. 3. Donaldson G., *Corporate Restructuring*, Harvard Business School Press, Boston, 1994.

[26] Molinterni R., *La crescita dell'impresa di piccola dimensione*, Cedam, Padova, 2000, p. 15.

[27] Ceccherelli A., *Introduzione allo studio della ragioneria generale*. *Gli organismi aziendali*, Le Monnier, Firenze, 1923, p. 106 ff. Pelrose E.T., *The Theory of the Growth of the*

ditions that favour development do have an impact on the role that a company plays within its context and might also result in growth[28]. In practice, any qualitative growth is usually followed by quantitative growth[29] in the near or distant future.

The objectives of growth and development are crucial to the survival of companies in the long term. During a company's lifecycle, decisions are taken with a view to encourage future growth and development. Also, in the course of a crisis, when the main goal is to preserve the operational scope or even save the company from bankruptcy[30], choices are made with consideration for future growth and development. Growth is consistently pursued during the whole lifecycle of a company[31].

Each and every strategic choice comes after the assessment of both the role and the competitive position that the company holds in its context. This is also due to the fact that companies diffuse not only financial resources but also elements, attitudes and restrictions, which might cause a given policy to be beneficial or detrimental in terms of growth or development. Moreover, any decision that impacts on such processes has to be carefully assessed; for example, an increase in size might force the company to deal with unpredictable consequences such as meeting new needs, finding alternative suppliers, operating in larger target markets, coordinating different aspects of management, etc. When not properly managed, an increase in size might be detrimental to the company or companies involved, including in terms of profitability.

Growth should not be seen as a necessary condition for companies to function in the long run. This is the case with small businesses that operate in market niches and that are competitive even though they do not increase their size[32].

In order to grow, businesses should aim towards goals that favour the

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Firm, London Press, London, 1959. Corbetta G., *Le aziende familiari*. *Caratteri originali, varietà e condizioni di sviluppo*, Egea, Milano, 1995, p. 71. Giaccari F., *Le aggregazioni aziendali,* Cacucci, Bari, 2003, p. 27.

[28] Cescon F., *Il controllo di gestione nello sviluppo e nel risanamento aziendale*, Cedam, Padova, 1988, p. 34.

[29] Coda V., *L'orientamento strategico dell'impresa*, Utet, Torino, 1988, p. 5.

[30] Giacosa E., Mazzoleni A., *Il progetto di risanamento dell'impresa in crisi*, Giappichelli, Torino, 2012.

[31] Gardi F., *Fusioni e altre combinazioni di imprese*, Egea, Milano, 1990, p. 4. Dematté C., "Modello di gestione e ciclo di vita delle imprese", *Economia & Management*, 3, 2001, pp. 5 ff.

[32] Cortesi A., *La crescita delle piccole imprese*, cit., pp. 51 ff.

premise of growth:

a) in terms of production, companies should reach a good level of productivity compared with that of their competitors. If they fail to do so, their line of products would lose attractiveness, which would affect business in terms of size growth. Productivity has a positive effect on profitability, competitiveness and social performance, all of which favour the creation of new resources that might be invested to achieve growth. Poor productivity jeopardises the beneficial effects of growth, since it causes the company to be easily outperformed by its competitors[33]. Furthermore, businesses should aim to develop their line of products through substantial investments in R&D and innovation; the level of innovation of both products and processes has a flywheel effect on growth. Innovation results in reduced manufacturing costs, a more efficient production cycle and a more attractive line of products with new or improved items. Furthermore, innovation should be aimed at updating operational and logistic skills with the purpose of improving both effectiveness and efficiency; and

b) in terms of sales, businesses should improve their market reach by targeting new geographical areas along with new segments of customers. In order to do so, they have to adapt to a rapidly changing environment, especially when they operate in a global context[34]. More scrupulous attention to customer care might encourage loyalty, which is a necessary condition for a company to guarantee adequate turnover.

[33] Mazzola P., *Produttività e crescita delle imprese*, Egea, Milano, 2002, pp. 45, 116.

[34] Sinatra A., *Impresa e sistema competitivo: strategie di innovazione e strategie di consolidamento*, Utet, Torino, 1989.

4.2 The Process of Company Growth

The process of growth might be defined in terms of the strategies through which it is achieved[35]:

a) internal growth; and
b) external growth.

Such strategies share a number of general features, in addition to the elements that specifically characterise a given company and its context. Defining these general features might be useful for the purpose of assessing the costs and benefits associated with each kind of growth strategy.

When comparing internal and external solutions, advantages and disadvantages might be weighed up by considering the various variables of decision making: the extent to which a decision is reversible, the level of risk, the impact of any decision and the soundness of alternative choices. Although internal growth is usually juxtaposed with external growth, internal and external development strategies are often undertaken in a converging way: external growth and internal growth are complementary[36].

Internal growth is pursued through the use of internal and external financial resources together with the technological, managerial and entrepreneurial skills owned by the company. Businesses operate according to their own potential in terms of organisational structure, manufacturing system and financial resources[37].

Internal growth is favoured by various factors, such as the growth trends in the relevant sector and the availability of proactive human resources with a

[35] Albertini S., *Gli accordi strategici,* Egea, Milano, 1991, p. 22 ff. Giaccari F., *Le aggregazioni aziendali,* cit., p. 30 ff. Potito L., *Le operazioni straordinarie nell'economia delle imprese,* Giappichelli, Torino, 2009, p. 8 ff. Conca V., *Le acquisizioni*, cit., pp. 13 ff. Giacosa E., *L'economia della aziende di abbigliamento*, cit., p. 262. Please also refer to Corticelli R., *La crescita dell'azienda*. *Ordine ed equilibrio nell'unità produttiva*, cit. Cavalieri E., Ranalli F., *Economia aziendale*, vol.II, Giappichelli, Torino, 1999. Paolone G., *L'Economia delle imprese societarie*, Giappichelli, Torino, 1999. Singh H., Zollo M., *Globalization through acquisitions and alliances: an evolutionary perspective*, in Gatignon H., Kimberly J. (Eds.), *The Alliance on Globalizing*, Cambridge University Press, Cambridge, 2004.

[36] Marchini I., *La gestione strategica*, ASPI, Urbino, 1995, p. 231. Conca V., *Le acquisizioni*, cit., pp. 13 ff.

[37] Depperu D., Turati C., "Il disegno organizzativo delle alleanze tra imprese", *Sviluppo & Organizzazione*, 132, 1992, p. 19 ff. Fazzini M., *Aggregazioni, accordi e alleanze tra imprese*, cit., p. 7.

talent for innovation[38]. Internal growth is closely related to the presence of entrepreneurship, aimed at appreciating the skills and resources available in the company[39]. This can be attained by encouraging staff to make suggestions and to create conditions that are favourable to business.

Internal growth is ultimately aimed at gaining a greater market share in contexts where the company already operates; alternatively, it is directed at penetrating new markets, enlarging the line of products or undertaking a process of diversification[40]. Moreover, internal growth occurs at a level of risk that the company deems acceptable.

The main advantages related to internal growth are the following:

- companies use an appropriate amount of resources thanks to a consistent assessment of financial compatibility. Internal growth makes it possible to adapt investments to the actual needs of the company[41]. Not only is it compatible to the company's structure and skills, but it is also in line with the real identity of the company[42];
- new investments are more rapidly integrated into the company structure, which saves both money and time. This is due to the fact that, before starting a process of internal growth, the process itself is adapted to the size and the organisational structure of the company; and
- decision making becomes shorter and leaner: internal growth involves only one entity (the company), and it is not subject to any form of contract.

However, internal growth sets certain limits on the potential increase in company size: adopting a resource-based approach[43], businesses use internal knowledge, skills and financial resources and all of which are limited. In addition, it takes a longer time to get returns on investments, since businesses stand

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[38] Bertini U., *Strategie di sviluppo interno e forme organizzative*, in Gozzi A. (eds.), *La definizione e la valutazione delle strategie aziendali*, Etas, Milano, 1991, p. 181.

[39] Invernizzi G., *I contributi forniti dalla letteratura*, in Invernizzi G., Molteni M., Sinatra A., *Imprenditorialità interna: lo sviluppo di nuove attività nelle imprese*, Etas, Milano, 1988, p. 35.

[40] Cortesi A., *Le operazioni di acquisizione*, cit., p. 29.

[41] Confalonieri M., *Lo sviluppo e la dimensione d'impresa*, Giappichelli, Torino, 1998, p. 98.

[42] Potito L., *Economia delle operazioni straordinarie d'impresa*, cit., p. 10.

[43] Wernerfelt B., "A Resource-Based View of the Firm", *Strategic Management Journal*, 5, 1984, pp. 171 ff.

alone when trying to sell their products, enter new markets and strengthen their presence in existing ones. When business opportunities outsize such potential, companies are forced to choose between two options: either give up their projects or favour external growth.

What follows is an analysis of external growth, which is the focus of this chapter.

Strictly speaking, external growth occurs in the operations through which companies acquire shares or assets from other businesses, in order to control them[44]. Companies pursue external growth by combining with other companies through more or less intense and formalised deals. Such combination results in synergies that pertain to both large and small businesses[45]. In large companies, synergies enable the newly established corporation or the informal cluster of companies involved to obtain economies of scale. In small businesses, synergies are aimed at exploiting the knowledge and skills owned by niche companies, which are usually characterised by a considerable attitude towards innovation.

The relations between companies are directed to use complementary resources that belong to different subjects[46] with the purposes of gaining direct or indirect control of such resources as well as generating synergies. In order to do so, business combination is deemed to be effective inasmuch as it favours access to the resources of the partner(s), which might be necessary because of the changeable conditions of the given context. Moreover, jobs undergo a process of reorganisation; the skills and attitudes of the involved parties are enhanced[47]. In the case of small companies, business combination enables them to deal with financial and structural shortages by exploiting unused creative potential.

Any process of external growth shares one of the following strategies[48]:

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[44] Conca V., *Le acquisizioni*, cit., p. 25.

[45] Mazzola P., Visconti F., "Percorsi di sviluppo per la piccola e media impresa", *Economia & Management*, 20, 1991, p. 203.

[46] Doz Y.L., Hamel G., *Alliance advantage*, Harvard Business Scholl Press, Boston, 1998.

[47] Del Baldo M., "Determinanti e condizioni delle strategie di "non crescita" delle piccole imprese", *cit.,* p. 66.

[48] Potito L., *Le operazioni straordinarie nell'economia delle imprese,* cit., p. 5 ff. Giacosa E., *L'economia della aziende di abbigliamento*, cit., p. 261. The literature has focused on a number of models that illustrate the processes of external growth. Please refer to Cortesi A., *La crescita delle piccole imprese*, cit., pp. 62 ff.

a) neither lines of products nor market segments are modified. Companies aim at taking advantage of unexploited potential demand and obtaining economies of scale. In order to improve their market reach, companies have to attract their competitors' customers. The company tries to improve the visibility of their existing products;

b) market segments are not modified, but lines of products are either expanded or renewed. The purpose is to increase the demand by differentiating the company's products from those of their competitors. Companies aim at consolidating or expanding their market reach by differentiating or renewing their own line of products;

c) lines of products are not modified, but new markets are reached, both in a geographical sense (for instance, when new stores are opened in the Asian market) and in terms of new market segments (for example, through brand extension). Also, this strategy focuses on existing lines of products; or

d) both lines of products and market segments are modified. This strategy is coherent with diversification policies[49], in that companies aim at expanding their lines of products as well as reaching new segments and markets, defined in a geographical sense or in terms of customer segments[50]. Usually, companies pursue diversification when the market and/or the sector in which they operate is saturated and consequently does not guarantee an adequate level of profitability, neither in current nor in perspective terms[51]. Product diversification might be implemented through an expansion of the line of products, penetration into new sectors and markets (considered as geographical areas as well as customer segments), the use of new technologies and the use of different distribution channels[52].

[49] Berry C.H., *Corporate growth and diversification*, Priceton University Press, Princeton, 1975. Hassid J., "Diversification and the firm's rate of growth", *The Manchester School of Economic Social Studies*, 45, 1977, pp. 16 ff. Jacquemin A.P., Berry, C.H., "Entropy measure of diversification and corporate growth", *Journal of Industrial Economics*, 27(4), 1979, pp. 359 ff.

[50] Ansoff H.I., "Strategies for diversification", *Harvard Business Review*, 35(5), 1957, pp. 113 ff. Christensen H.K., Montgomery C.A., "Corporate Economic Performance: Diversification Strategy Versus Market Structure", *Strategic Management Journal*, 2(4), 1981, pp. 327 ff.

[51] Bettis R.A., Hall W.K., "Diversification Strategy, Accounting Determined Risk, and Accounting Determined Return", *Academy of Management Journal*, 25(2), 1982, pp. 254 ff.

[52] Pitts R.A., "Diversification strategies and organizational policies of large diversified firms", *Journal of Economics and Business*, 28(3), 1976, pp. 181 ff. Salter M.S., Weinhold W.A., *Diversification through Acquisition: Strategies for Creating Economic Value*. Free

Companies that decide to implement diversification strategies usually produce heterogeneous outputs[53], which do not depend on company size[54]. In particular, products are not diversified if they show only intrinsic differences; the output might be considered "diverse" when different products target different markets or when the resources and the skills used to manufacture one specific product cannot be used to manufacture another.

Diversification strategies might be classified on the basis of various criteria. When such strategies are implemented within one sector, it is defined as single-sector diversification; on the contrary, when diversification stretches to more than one sector, it is described as multi-sector diversification. On the basis of the technology level of a company's line of products, diversification might be lateral or conglomerate. The first involves new products that maintain the same technology level as existing products; usually, such diversification is pursued through internal growth, i.e. the company has set up new manufacturing units. In the latter, not only does the new line of products achieve a different technology level, but also the markets and sectors involved are different. Usually, such diversification is pursued through external growth, i.e. with two or more companies involved[55].

The literature has analysed the impact of diversification on resource investment[56], business growth[57] and company performance[58]. Diversification

Press, New York, 1979. Goold M., Luchs, K., "Why Diversify? Four Decades of Management Thinking", *Academy of Management Executive,* 7(3), 1993, pp. 7 ff.

[53] Cortesi A., *Le acquisizioni di imprese*, Egea, Milano, 2000, p. 68.

[54] Aw B.Y., Batra G., "Firm size and the pattern of diversification", *International Journal of Industrial Organization*, 16 (3), 1998, pp. 313 ff.

[55] Giaccari F., *Le aggregazioni aziendali,* cit., p. 41 ff.

[56] Chatterjee S., "Types of Synergy and Economic Value: The Impact of Acquisition on Merging and Rival Firms", *Strategic Management Journal*, 7(2), 1986, pp. 119 ff. Chatterjee S., Wernerfelt B., "The Link between Resources and Type of Diversification: Theory and Evidence", *Strategic Management Journal*, 12(1), 1991, pp. 33 ff. Miller D.J., "Technological diversity, related diversification, and firm performance", *Strategic Management Journal,* 27(7), 2006, pp. 601 ff.

[57] Hassid J, "Diversification and the firm's rate of growth", *Manchester School of Economic & Social Studies,* 45(1), 1977, pp. 16 ff. Jacquemin A.P., Berry C.H., "Entropy measure of diversification and corporate growth", *Journal of Industrial Economics*, 27(4), 1979, pp. 359 ff.

[58] Rumelt R.P., *Strategy Structure and Economic Performance*, Harvard University, Boston, 1974. Jahera J.S., Lloyd W.P., Page D.E., "Firm diversification and financial performance", *Quarterly Review of Economics*, 27 (1), 1987, pp. 51 ff. Grant R.M., Jammine P., Tho-

strategies might improve performance thanks to the creation of synergies[59]. Such influence might vary in relation to the kind of strategy implemented; diversification in new or existing markets may require similar managerial skills whose availability does not incurring new costs. Alternatively, diversification might require new skills and consequently further investments[60]. A number of researches have focused on the relation between diversification strategies and risk[61]. Diversification strategies are implemented with the purpose of mitigating risk, in that companies attain various business scopes[62]: negative performance in one sector might be counterbalanced by positive performance in another. In addition, diversification allows for companies to increase their size and gain a leading position in relevant markets.

The following table outlines the four strategies of external growth (Figure 4.1).

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mas H., "Diversity, diversification and profitability among British manufacturing companies, 1972-1984, *Academy Management Journal,* 31(4), 1988, pp. 771 ff. Datta, D.K.; Rajagopalan, N., Rasheed A.M., "Diversification and performance: critical review and future directions", *Journal of Management Studies*, 28(5), 1991, pp. 529 ff. Chatterjee S., Blocher J.D., "Measurement of firm diversification: is it robust?", *The Academy of Management Journal,* 35(4), 1992, pp. 874 ff. Lim G.E., Teck, T.Y., "Diversification strategies, firm characteristics and performance among Singapore firms", *International Journal of Management*, 12(2), 1995, pp.223 ff. Lins K., Serveas H., International Evidence on the value of corporate diversification, *Journal of Finance,* 5(6), 1999, pp. 2215 ff. Maurer F., "Performance boursière: rendement/risqué et mode de diversification", *Revue Finance Contrôle Stratégie* 6(1), 2003, pp. 93 ff. Chakrabarti A., Singh K. Mahmood I., "Diversification and performance: Evidence from East Asian firms", *Strategic Management Journal,* 28(2), 2007, pp. 101 ff. Santalo M., Becerra M., "Competition from Specialized Firms and the Diversification-Performance Linkage", *Journal of Finance*, 63(2), 2008, pp. 851 ff.

[59] Clarke C.J., Brennan K., "Building Synergy in the Diversified Business", *Long Range Planning*, 23(2), 1990, pp. 9 ff. Berger P.G, Ofek E., "Diversification's effect on firm value", *Journal of Financial Economics,* 37(1), 1995, pp. 39 ff. Palich L.E., Cardinal L. B., Miller C. C., "Curvilinearity in the Diversification-Performance Linkage: An Examination of over Three Decades of Research", *Strategic Management Journal,* 21(2), 2000, pp. 155 ff.

[60] Salter M.S., Weinhold W.A., *Diversification through Acquisition. Strategies for Creating Economic Value*, cit.. Elgers P.T., Clark J.J., "Mergers Type and Stockholder Returns: Additional Evidence", *Financial Management*, 9 (2), 1980, pp. 66 ff.

[61] Bettis R.A., Hall W.R., "Diversification strategy, accounting determined risk and accounting determined return", cit., pp. 254 ff. Montgomery C.A., Singh H., "Diversification strategy and systematic risk", *Strategic Management Journal,* 5(1), 1984, pp. 181 ff. Kahloul I., Hallara S., "The Impact of Diversification on Firm Performance and Risk: An Empirical Evidence", *International Research Journal of Finance and Economics,* 35, 2010, pp. 150 ff.

[62] Biggadike R., "The Risky Business of Diversification", *Harvard Business Review*, May-June, 1979, pp. 103 ff.

Line of products			
	Existing	Focus on existing products	Focus on existing products and existing market/market segment
	New	Diversification strategies	Focus on existing market/market segment
		New	Existing
		Markets or market segments	

Figure 4.1 The strategies of external growth
Source: Personal elaboration

External growth has a number of advantages:

- goals are pursued more rapidly and in a more cost-effective way than through internal growth. Synergies between actors already operating in the business make it possible for the subjects involved to share existing knowledge and resources, which are often limited. These include technological resources, know-how, a consolidated presence in markets that are characterised by barriers to entry and a well-functioning structure. In this sense, the immediateness factor[63] is deemed crucial for the success of any growth strategy;
- thanks to the integration of all parties involved, resources from other companies are made available. Such resources might be material, like labour, raw materials, machinery and equipment; or immaterial, such as information, know-how and organisational structures. Some of these are not easily accessible through traditional market transactions, in that they are strictly related to the context in which they have been created. This is the case with the know-how acquired by a niche company with which a business combination is arranged;
- companies strengthen their competitive position in the market and improve corporate visibility. Companies often buy a competitor, although weaker, in order to gain a greater market share and achieve both a dominating role and a

[63] Potito L., *Economia delle operazioni straordinarie d'impresa*, cit., p. 8.

competitive advantage[64]. Sometimes, they aim at overcoming barriers to entry[65] in contexts asking for requisites that the partner company has. Whenever businesses achieve control of a resource that is not easily accessible by their competitors, they make it difficult for other companies to create a certain product;

- companies gain financial and tax benefits that could not be gained otherwise, especially when business combination takes place with companies that have specific characteristics or are located in certain countries; and
- the financial resources needed to reach a certain size are less conspicuous than those needed in contexts of internal growth requiring a financial investment.

Beside these advantages, external growth also entails some disadvantages:

- the differences in the management style attitudes of the companies involved might cause problems from a strategic point of view in the subsequent post-combination integration and thus might affect business, especially in the medium/long run[66];
- differences in corporate culture[67], as well as in well-established operational and organisational models that might be difficult to integrate, might cause problems of post-combination integration. Such differences might cause the company to bear adaptation and implementation costs[68];
- business combination may cause duplicate resources or cause unnecessary

[64] Barney J., “Firm resources and sustained competitive advantage”, *Journal of Management*, 17(1), 1991, pp. 99 ff. Hopkins H.D., “Acquisition Strategy and the Market Position of Acquiring Firms”, *Strategic Management Journal*, 8, 1987, pp. 535 ff.

[65] Sudarsanam P.S., “The Role of Defensive Strategies and Ownership Structure of Target Firms: Evidence from UK Hostile Takeover Bids”, *European Financial Management*, 1(3), 1995, pp. 223 ff.

[66] Datta D.K., “Organizational Fit and Acquisition Performance: Effects of Post-Acquisition Integration”, *Strategic Management Journal*, 12(4), 1991, pp. 281 ff.

[67] Ragiadini A., *Organizzazione d’impresa*, Giuffré, Milano, 1979. Martin J., Siehl C., “Organizational Culture and Conterculture: an Uneasy Symbiosis”, *Organizational Dynamics*, Autumn, 1983, pp. 52 ff. De Noble A.F., Gustafson L.T., Hergert M., “Planning for Post Merger Integration-Eight Lessons for Merger Success”, *Long Range Planning*, 21(4), 1988, pp. 82 ff. Siehl C., Ledford G., Silverman R., Fay P., “Preventing Culture Clashes From Botching a Merger”, *Acquisition Monthly*, March-April, 1988, pp. 51 ff. Malekzadeh A.R., Nahavandi A., “Making Mergers Work by Managing Cultures”, *The Journal of Business Strategy*, May-June, 11(3), 1990, pp. 55 ff.

[68] Jemison D.B., Sitkin S.B., “Corporate acquisitions: a process perspective”, *Academy of Management Review*, 11(1), pp. 145 ff.

resources to become available, since each company involved contributes their existing resources; and

- a partner's potential might be over- or under-estimated, which would create a situation quite different from the intended scenario. When partners are not sufficiently engaged, or are unable to engage, these strategies might lose scope and be doomed to fail[69].

The following table contrasts internal and external growth in relation to growth mechanisms, advantages and disadvantages (Figure 4.2).

Kind of growth	Growth mechanisms	Advantages	Disadvantages
Internal	Investment of financial resources (with internal and external origin), technologies and managerial skills available in the company	Investments are not over- or under-sized	Companies can count only on their attitudes, know-how and skills
		New investments are rapidly integrated into the existing structure	Longer investment cycles
		Leaner decision-making processes	
External	Formal and informal combinations with other companies	Objectives are reached more rapidly and cost-effectively	Different management attitudes
		Resources of other companies are made available	Different corporate culture
		Competitive position becomes stronger	Difficulties in integrating existing operational and organisational models
		Financial and tax benefits	Duplication of resources or unnecessary resources made available
		Need for less conspicuous financial resources	Incorrect assessment of partner's potential

Figure 4.2 Internal and external growth: a contrast

Source: Personal elaboration

The concept of external growth is further developed in the following sections.

[69] Mazzola P., Visconti F., "Percorsi di sviluppo per la piccola e media impresa", *Economia & Management*, 20, 1991, p. 217.

4.3 Business Combination in the Context of External Growth

Since companies are not self-sufficient, it is not possible for them to acquire and manage all the resources that might be needed for them to develop and expand. Therefore, they may need to obtain resources and skills from other companies. It is in view of their future that businesses carry out business combination.

Business combination[70] is defined as a deal (to various extents of formalisation) that causes part of a company or the whole of it to share certain objectives with other companies or to pursue a given development path. The ensuing relationships, when properly managed, enable each of the subjects involved to operate in a more cost-efficient way. This happens when, for instance, two companies reach a deal to jointly acquire means of production or to jointly undertake R&D activities.

Although, generally speaking, business combination does bring advantages in terms of financial and economic balances, it might also limit a company's autonomy. Such limitation might be more or less severe depending on the kind of relationships existing among the businesses involved. This can be seen from different perspectives. From an objective point of view, it is related to the autonomy in reaching the balances that enable companies to exist in the long run. From a subjective point of view, it is defined as the possibility to direct business towards set objectives. Even though deals among companies are diverse, they are, generally speaking, aimed at maintaining, improving or retrieving the balances of the company[71].

The operations related to business combination are influenced by a company's goals in terms of size[72]: when businesses are driven by the objective of

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[70] Giaccari F., *Le aggregazioni aziendali,* cit., p. 11 ff. Mergers are considered as specific relations established among companies; they are related to several aspects of management and have a considerable impact on the organisational and operational structures of the subjects involved. Galassi G., *Concentrazione e cooperazione interaziendale*, Giuffré, Milano, 1969. Andrei P., Azzali S., Bisaschi A., Fellegara A.M., *Le aggregazioni d'impresa*, Giuffré, Milano, 1999.

[71] Cassandro P.E., *I gruppi aziendali,* Cacucci, Bari, 1982, pp. 19 ff.

[72] The literature has long debated the concept of company size. Some researchers have related it to the volume of production or to the level of turnover that is deemed adequate for a company to reach on a periodical basis. Please refer to, among others, Zappa G., *Le produzioni nell'economia delle imprese*, *tomo I*, Giuffré, Milano, 1956, pp. 327 ff. Bianchi T., *L'autofinanziamento*, Giuffré, Milano, 1963, pp. 71 ff. Cattaneo M., *Le imprese di piccole e medie dimensioni*, Istituto Editoriale Cisalpino, Milano, 1963, pp. 53 ff. Amaduzzi A., *Osservazioni intorno al concetto di dimensione aziendale*, Giuffré, Milano, 1964. Onida P., *Econo-*

increasing their size, they might be driven towards new types of combination that increase business opportunities[73].

The relationship required in business combination might have different economic characters, depending on the kind of economic relations existing among the companies involved and on the circumstances that have led to the combination itself. Business combination is often a Hobson's choice when competition is so fierce as to require a vast range of skills that might be difficult for companies to acquire by themselves. In such a scenario, cooperation among two or more companies makes it possible for them to carry on business in a more competitive way[74].

The literature has listed other criteria to classify combinations, such as the extent to which the subjects involved are interrelated, which impacts on the possibility of reversing the post-combination scenario[75].

According to some scholars, by relating the post-combination transformation to the intensity of the integration among the companies involved, it is possible to identify the following types of business combination: formal corporations, characterised by close integration and a formalised deal (acquisitions and joint ventures); networks, in which integration is weak and non-formalised (as in all cases of informal cooperation); and formalised relations, which are considered a between category in which deals might be more or less formalised and integration has mid-span intensity (franchising, consortia, and

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mia d'azienda, Utet, Torino, 1968, pp. 321 ff. Amaduzzi A., *L'azienda nel suo sistema e nell'ordine delle sue rilevazioni*, Utet, Torino, 1969, pp. 83 ff. Bertini U., *Introduzione allo studio dei rischi nell'economia aziendale,* Colombo Cursi, Pisa, 1969, p. 23. The following books provide further information: Corticelli R., *La dimensione dell'azienda sotto il profilo economico, in Saggi di ragioneria e di economia aziendale*, Cedam, Padova, 1987. Cavalieri E., *Sul tema della dimensione d'impresa*, Cedam, Padova, 1995. Confalonieri M., *Lo sviluppo e la dimensione dell'impresa*, Giappichelli, Torino, 1998. It is worth specifying that the concept of size varies according to the context in which businesses operate: a company might be considered large or small in different geographical contexts. Giaccari F., *Le aggregazioni aziendali,* cit., p. 21.

[73] Cassandro P.E., *I gruppi aziendali,* cit., p. 25. Giaccari, *Le aggregazioni aziendali,* cit., p. 14 ff. Passaponti B., *I gruppi aziendali e le altre aggregazioni aziendali*, Giuffré, Milano, 1994, p. 14.

[74] Child J., Faulkner D., *Strategies for co-operation. Managing, Alliances, Networks and Joint Ventures*, Oxford University Press, New York, 1998.

[75] Williamson O.E., *Markets and Hierarchies. Analysis and Antitrust Implications*, The Free Press, New York, 1975.

deals of exclusivity with customers and suppliers)[76].

Other scholars have combined different criteria, such as the kind of integration required in the post-combination stage, the extent to which deals are formalised, and the number of companies involved. The following types of business combination have been defined: groups, characterised by one economic subject, a number of companies and either vertical or horizontal post-combination integration (joint ventures); formal associations of companies, in which a number of companies reach a formal deal without identifying one economic subject (cartels, consortia and franchising associations); and informal associations of companies, in which a number of companies arrange an informal deal with no economic subject (subcontracting networks and districts)[77].

Another widely used criterion is the extent of formalisation characterising the business combination, according to which the following types might be identified[78] (Figure 4.3):

1) formal combinations: they result from deals that are made official through juridical ties, which define the kind, scope and duration of the deal. Such deals (generally in the medium/long term) allow for the joint use of the resources and the skills of the parties involved, in order to carry out a shared project of development. They include strategic alliances, company leases, consortia and franchising; and

2) informal combinations: they result from deals that are not made official through any juridical tie. They occur among companies that have established economic, financial and sales relations. Such deals are reached among companies that remain juridically autonomous and that agree to undertake to cooperate with the purpose of reaching a profitable coordination for each and every subject involved[79]. Such coordination might be related to any function[80]: production and logistics, R&D, marketing, human resources, etc. This type of combination is based on the need to find complementary resources at a given time. In order to get such resources, companies have a number of strategic op-

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[76] Boldizzoni D., "La crescita per linee esterne delle piccole imprese", *Sviluppo & Organizzazione,* 131, maggio/giugno, 1992.

[77] Airoldi G., Brunetti G., Coda V., *Lezioni di economia aziendale*, Il Mulino, Bologna, 1994, pp. 386 ff.

[78] Giaccari F., *Le aggregazioni aziendali,* cit., p. 64 ff.

[79] Bastia P., *Gli accordi tra imprese*, Clueb, Bologna, 1989, p. 65.

[80] Lai A., *Le aggregazioni di imprese*, Franco Angeli, Milano, 1990, p. 28.

tions: they might pursue internal growth, purchase resources on the market or cooperate with other businesses[81]. Such cooperation may also be occasional. The synergies created assist in maintaining or reaching conditions of "economisation"[82]: they make informal deals a no minor means[83]. Such deals might

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[81] Cortesi A., *La crescita delle piccole imprese*, cit., p. 125.

[82] From Giacosa E., Mazzoleni A., *Il progetto di risanamento dell'impresa in crisi*, Giappichelli, Torino, 2012, p. 50. "Economization" ("economicità") is defined as the aptitude of company to operate as long-lasting economic mean; that is, to exist in the long term by functioning as economic mean. An aptitude to economization in the long run does not preclude the fact that, in certain periods of their life, company might operate in a non-economic way. Nevertheless, in the long run, economization represents the aptitude that makes any company a long-lasting economic means. Ferrero G., *Istituzioni di economia d'azienda*, Giuffré, Milano, 1968, p. 198 ff. Ranalli F., *Considerazioni sul tema dell'economicità aziendale*, Clua Editrice, Pescara, 1988. Bianchi C., *Il modello aziendale come modello di economicità*, Edizioni Kappa, Roma, 1993. Therefore, company is considered as phenomenon of long-lasting economization. Giannessi E., *Le aziende di produzione originaria, Volume primo - Le aziende agricole,* Colombo Cursi Editore, Pisa, 1960, p. XIV. Economization looks at the economic balance from a point of view that is internal to the company. Buccellato A., *Il sistema informativo delle aziende pubbliche,* Cedam, Padova, 1992, p. 119. Company lacking economization cannot last long: it is not economically autonomous, in that it lacks the characteristic of a systems that would make them long-lasting economic means (Cassandro P.E., *Le aziende. Principi di ragioneria*, Cacucci, Bari, 1962, p. 43. Paolini A., *Le condizioni di equilibrio aziendale*, in Marchi L. (eds.), *Introduzione all'economia aziendale*, Giappichelli, Torino, 1998, p. 481). In other words, company lacking economization does not have an aptitude to exist (Zappa G., *Le produzioni nell'economia delle imprese, Vol. I,* Giuffrè, Milano, 1957, p. 65): it either disappears or survives thanks to the economic liveliness of others. In order for a company to be autonomous, it should be self-sustained from an economic point of view, i.e. it should be able to do business while being in a situation of economic balance (Onida P., *Economia d'azienda,* Utet, Torino, 1960, p. 57 ff.). Companies should be able to efficiently acquire and pay off their means of production. Such aptitude does not have to be stable over time: the absence of balance might momentarily occur in the short term because of unfavourable conditions. During such periods, companies survive as long as losses are made up for with profits made in the past or to be made in the future. Cricchio S., *L'impresa come momento di origine e di diffusione di fenomeni macro-economici,* Giuffré, Milano, 1980, p. 82. Therefore, a company's aptitude to be economically self-sufficient has to be assessed in the long term. Zuccardi Merli M., *Il sistema informativo contabile per la determinazione dell'equilibrio economico*, in Anselmi L. (eds.), *L'equilibrio economico nelle aziende sanitarie*, Il Sole 24 Ore Libri, Milano, 1996, p. 41. Pucci S., *Alcune riflessioni sull'economicità, efficacia ed efficienza negli enti locali*, Giappichelli, Torino, 2003. Companies characterised by long-term economization are not only economically autonomous but also financially self-sustained (Onida P., *Economia d'azienda*, Utet, Torino, 1960, p. 390 ff.); since financial self-sufficiency is not perceptible in every moment of company life, the aptitude of liquidity is measured, in terms of ability to meet the financial requirements in an economical and timely way.

also be arranged within a competitive scenario: when two or more competitors reach a cooperation deal, they establish competitive cooperation.

Informal combinations might generate various relationships among the companies involved[84]:

a) horizontal relationships: cooperation is established among companies operating in similar activities. This drives them to share certain activities. It follows that the risks associated with the joint project are mitigated. Moreover, each company acquires the knowledge and skills of the partner(s)[85];
b) vertical relationships: cooperation takes place between a company and other subjects that play a role at an earlier and/or later stage of the supply chain. Cooperation is focused on labour specialisation, as well as on the exploitation of the distinctive skills of the companies involved. The assumption here is that the existing know-how and the pre-combination background are asymmetrical; and
c) transverse relationships: they refer to companies operating in different manufacturing and distributive contexts. This is the case, for instance, with a watch manufacturing company that decides to cooperate with a distributor operating in the clothing industry.

[83] Richardson G.B., "The Organization of Industry", *The Economic Journal*, 82(327), 1972, pp. 883-896.

[84] Cortesi A., *La crescita delle piccole imprese*, cit., pp. 119 ff.

[85] Sicca L., *La gestione strategica dell'impresa*, Cedam, Padova, 1998, p. 524.

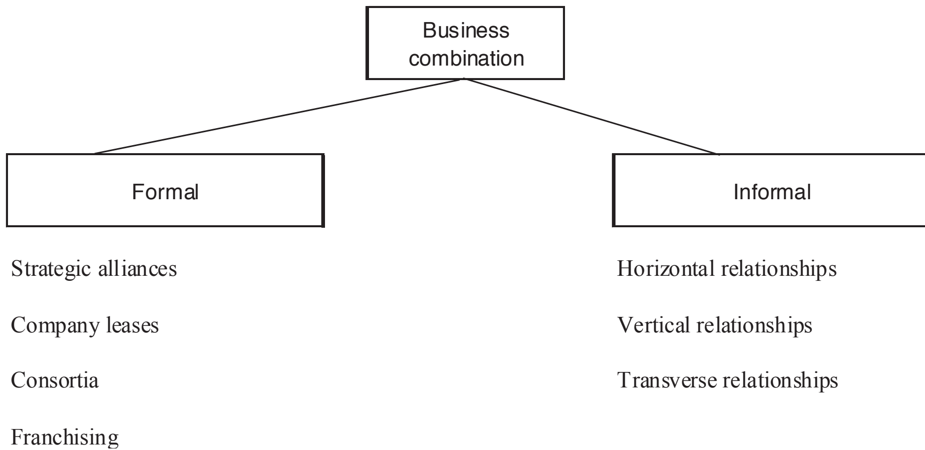

Figure 4.3 Types of combination in relation to formalisation
Source: Personal elaboration

The reasons behind informal combinations are various:

a) technical-productive and commercial reasons: regarding the former, companies combine with others in order to acquire greater flexibility in production, obtain economies of scale, increase specialisation and gain a greater market share. Moreover, whenever deals are focused on transferring technology, they are also aimed at exploiting other companies' resources and knowledge. Regarding the latter, companies combine in order to gain a greater market share, either by reducing the times and costs related to reaching new markets or by strengthening their presence in existing contexts.

This category includes: subcontracting networks, constellations and industrial districts;

b) personal reasons: combinations are accounted for by the sense of honour and responsibility of the subjects involved. This is the case of gentlemen's agreements; and

c) financial reasons: companies combine with others in order to obtain financial resources from other subjects, on whom they grow dependent.

The strongest forms of combination are mergers and acquisitions, whereas cooperation deals (that might be more or less formalised) are the weakest.

In conclusion, business combination might pursue various objectives (Figure 4.4):

a) integration among the companies involved: when the relationships among the companies are strong and their interest to cooperate is not occasional, mergers and acquisitions (M&A) often occur. The purchasing company acquires the resources of another one, which loses its decision-making autonomy. In order to complete this process, post-combination integration is crucial;

b) cooperation among the parties involved: when companies do have stable relations among them, they can cooperate and maintain their juridical and economic autonomy at the same time. Such cooperation might be mutual and require a considerable degree of post-combination integration. This is the case with strategic alliances; and

c) collaboration among the parties involved: when the relationships among companies are not stable over time, companies might choose to cooperate while maintaining their juridical and economic autonomy. Such cooperation does not require a considerable degree of post-combination integration. This is the case with deals.

Relationship among companies		Degree of integration: High	Degree of integration: Low
	Strong	Mergers and acquisitions (M&A)	Other types of deals
	Weak	Cooperation	Collaboration

Figure 4.4 Types of business combination in relation to objectives

Source: Personal elaboration

There might also be various types of business combination according to the extent to which they are reversible. The most reversible operations are those that require the lowest degree of integration among the companies involved,

i.e. deals between companies. The least reversible are mergers, in that they require a high degree of integration among the parties involved. Acquisitions are less reversible than joint ventures, in which parties maintain their juridical, financial and economic autonomy (Figure 4.5).

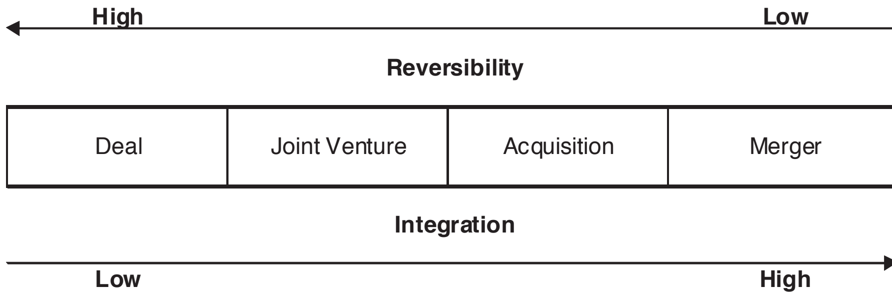

Figure 4.5 The reversibility of combinations

Source: Personal elaboration

The following paragraphs analyse two types of business combination that are frequent in the context of luxury business:

a) strategic alliances, as an example of formal business combinations; and
b) subcontracting, as an instance of informal business combinations.

4.3.1 Strategic Alliances

Strategic alliances are defined as cooperation deals[86] allowing for external growth in the medium and long term. They are negotiated between a company and one or more third parties, which become its manufacturing and/or commercial partners and maintain their juridical autonomy at the same time[87]. One of the companies involved plays a leading role; it is often a very important customer, if not the only one, of the subjects involved. It performs the func-

[86] Comuzzi E., *La misurazione della performance nelle aggregazioni aziendali,* Cedam, Padova, 1996, p. 5 ff.

[87] Pellicelli G., *Strategie di impresa*, Egea, Milano, 2010, p. 344 sffs. Giacosa E., *L'economia delle aziende di abbigliamento*, cit., pp. 277 ff. The literature has defined a number of theories that analyse the reasons behind strategic alliances. Since this book does not aim at being exhaustive, please refer to Cortesi A., *La crescita delle piccole imprese*, cit., pp. 95 ff.

tions of leading and coordinating the operations carried out by the other partners[88], whose organisational ties are often large and highly complex[89]. Therefore, alliances represent a form of growth along with other third parties (make together)[90].

Partners are assigned one or more activities that would otherwise have been carried out by the company itself. Therefore, strategic alliances might be considered one of the means through which contractual growth takes place. Other forms of contractual growth included in Faulkner's[91] model are the following[92]:

a) stable supply networks, in which the customer-supplier relation develops, becomes stronger and ultimately leads to stable forms of cooperation between the parties;
b) weak cooperation networks, resulting from deals aimed at systematic cooperation that do not provide for sanctions towards non-complying companies;
c) Japanese keiretsu, which are stable supply relations resulting from corporate relations; and
d) licensing, in which companies that own a brand license third parties to use the brand when manufacturing and/or marketing specific products.

Licensing is especially frequent in the context of fashion and luxury goods, where it achieved a worldwide turnover in terms of royalties of about 200 billion dollars in 2011. The vast majority of this revenue is ascribable to the top 125 licensors. The royalties received by Italian licensors amounted to 350 million euros, with an increase of 6% compared to 2010. Some important companies have recently decided to revoke licences in order to manage activities internally; Burberry, for instance, has decided to manage its beauty segment internally. On the contrary, licensing is still used by companies that own a medium-profile brand, as it allows for a less rigid manufacturing structure. Licensing favours brand stretching policies, in that it expands brand presence to

[88] P. Bastia, *Gli accordi tra imprese*, cit., p. 41 ff.

[89] Pontarollo E., La Rocca R., *Le trame della maglia, le strategie della moda*, Franco Angeli, Milano, 1992, p. 12.

[90] Bursi T. (eds.), *Acquisizioni e alleanze nell'industria tessile-abbigliamento*, Franco Angeli, Milano, 1992, p. 23.

[91] Faulkner D., *International Strategic Alliances*, McGraw-Hill, London, 1995.

[92] Conca V., *Le acquisizioni*, cit., p. 17

new merchandise categories. When licensing is applied to accessories (such as shoes, bags and glasses), the strategy favours exports, inasmuch as accessories are usually the first products with which companies enter foreign markets. The most profitable categories are accessories, apparel and merchandising. For instance, licensing is particularly frequent in the segment of eyewear: large groups, such as Luxottica, Safilo, Marcolin and De Rigo, own the vast majority of licences[93].

In the context of strategic alliances, partners are chosen among subjects who are complementary from a manufacturing point of view, with the purpose of improving the company's manufacturing mix by using the partner's specific skills[94]. In some cases, partners might be chosen among the company's competitors; the synergies created with them might be profitable[95]. Often, the strategic alliance is set up with foreign partners in order to enter or consolidate the presence in an international market[96].

Strategic alliances might be carried out in different ways: in the form of simple access to the partner's knowledge, a transfer of know-how or in the joint creation of new knowledge[97]. This not only brings a series of economic

[93] Bello M., "I love licensing", *PambiancoMagazine*, 13, 2012, pp. 28-41.

[94] Ferrando P.M., *Subfornitura e approvvigionamenti nell'evoluzione del sistema aziendale,* Franco Angeli, Milano, 1984, p. 136 ff.

[95] Lei D., "Offensive and Defensive Use of Alliances", *Long Range Planning*, 26(4), 1993, pp. 32-41.

[96] Buckley P., Casson M., "A Theory of Co-operation in International Business", in Contractor F., Lorange P., *Cooperative Strategies in International Business*, Lexington Books, Lexington, 1988, pp. 31 ff. Ellram L.M., "International Purchasing Alliances: An Empirical Study", *The International Journal of Logistics Management*, 3(1), 1992, pp. 23 ff. Bleeke J., Ernst D. (eds.), *Collaborating to Compete: Using Strategic Alliances and Acquisitions in the Global Market Place,* Wiley, New York, 1993. Mohr J., Spekman R., "Characteristics of Partnership Success, Partnership Attributes, Communication Behaviour and Conflict Resolution Techniques", *Strategic Management Journal*, 15(2), 1994, pp. 135 ff. Yigang P., Xiaolian L., "Alliance of Foreign Firms in Equity Joint Ventures in China", *International Business Review*, 7(4), 1998, pp. 329 ff. Mockler R.J., *Multinational Strategic Alliances*, Wiley, New York, 1999. Si S. X., Bruton G.D., "Knowledge Transfer in International Joint Ventures in Transitional Economies: The China Experience", *Academy of Management Executive*, 13, 1999, pp. 83 ff. Aimin Y., Zeng M., "International Joint Venture Instability: A Critique of Previous Research, a Reconceptualization, and Directions for Future Research", *Journal of International Business Studies*, 30(2), 1999, pp. 397 ff.

[97] Madhok A., "The organization of economic activity: Transaction Costs, Firm Capabilities, and the Nature of Governance", *Organizational Science*, 7(5), 1996, pp. 577 ff. Capaldo A., "Lo studio delle capacità relazionali dell'impresa: scelte epistemologiche,

advantages to the subjects involved but also creates a number of mutual obligations[98].

Alliances allow for the creation of a network or "companies network"[99] in which companies, though maintaining their juridical autonomy, are related because of these obligations. A "business network" is defined as an organisational solution directed at combining the know-how and skills of the companies involved. Business networks are aimed at increasing interaction and cooperation among the parties involved with the purposes of creating incentives to innovate and increasing their competitive advantage[100]. Companies maintain their juridical and decision-making autonomy: they each manage their own business[101].

Business networks mirror the tendency of companies to expand their activities beyond its borders. "Business borders"[102] are defined by applying the criterion of the subjective independence of each company in relation to external economic subjects[103]. This definition makes it possible to distinguish a company from its context by drawing up virtual borders within which the company operates. It allows the identification of "what is inside the company", "what is outside of it" and "what is neither inside nor outside of it"[104]. It has been argued that business borders separate the governance of a given company from that of another company[105].

When companies operate beyond their business borders, they are driven by strategies of product diversification, as well as by the wish of reaching new markets and of integrating themselves with other companies. The ultimate

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impianto teorico ed una proposta metodologica", *Finanza, Marketing e Produzione*, 17(1), 1999, pp. 7 ff.

[98] Oliver C., "Determinants of Interorganizational Relationships: Integration and Future Directions", *Academy of Management Review,* 15(2), 1990, pp. 241 ff.

[99] Giacosa E., *L'economia delle aziende di abbigliamento*, cit., pp. 247 ff.

[100] Mancini D., *L'azienda nella "rete" di imprese,* Giuffrè, Milano, 1999, p. 61. Zaghi K., "La distribuzione nel sistema moda", *Economia & Management,* 5/2003, p. 66.

[101] Lai A., *Paradigmi interpretativi dell'impresa contemporanea*, Franco Angeli, Milano, 2004, p. 141.

[102] Giacosa E., *L'economia delle aziende di abbigliamento*, cit., pp. 24 ff.

[103] Ferrero G., *Istituzioni di economia aziendale*, cit., p. 85.

[104] Garzella S., *Il sistema d'azienda e la valorizzazione delle "potenzialità inespresse",* Giappichelli, Torino, 2005, p. 5.

[105] Garzella S., *I confini dell'azienda*, Giuffrè, Milano, 2000, p. 26 ff.

goal is to improve efficiency while increasing their competitive advantage[106].

Borders are re-defined by establishing new types of relations with suppliers, which translate into forms of management cooperation as well as into lines of products with higher technology and innovation contents[107]. Cooperation is not only aimed at moving products or materials more efficiently; it is also directed at mutually involving the partners in transferring information, providing services which enhance the supplying relationship, sharing responsibilities within the supply chain[108].

Business networks can be classified on the basis of various criteria[109]:

a) network field of action: networks might be defined as internal or external. The former are created within a company; that is, among business units that are independent from an operative point of view. The latter are created with subjects external to the company with the purpose of generating synergies with the context; and

b) the intensity of the relations among the companies involved: networks might be described as stable or dynamic. The former are based on the stable involvement of a leading company in a number of companies, with the role of control and coordination; each single company might either operate within one network or work for a number of networks. The latter are short lived and have specific objectives related to their products, with the purpose of taking advantage of occasionally favourable situations.

A joint venture is an instance of a strategic alliance[110]: two or more eco-

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[106] Cavalieri E., Ranalli F., *Economia aziendale*, cit.

[107] Pearson N.J., Gritzmacher K.J., "Integrating Purchasing into Strategic Management", *Long Range Planning*, 23(3), 1990, pp. 91 ff. Dyer J.H., Ouchi W.G., "Japanese-Style Partnerships: Giving Companies a Competitive Edge", *Sloan Management Review*, 35(1), 1993, pp. 51 ff.

[108] Scott C., Westbrook R., "New Strategic Tools for Supply Chain Management", *International Journal of Phisycal Distribution and Logistics Management*, 21(1), 1991, pp. 23 ff. Braithwaite A., Christopher M., "Managing The Global Pipeline", The International Journal of Logistics Management, 2(2), 1991, pp. 55 ff.

[109] Giaccari F., *Le aggregazioni aziendali*, cit., p. 94 ff.

[110] Harrison J.S., "Alternatives to Merger, Joint Ventures and Other Strategies", *Long Range Planning*, 20(6), 1987. D'Amico L., *L'economia delle imprese associative,* Giappichelli, Torino, 1996, p. 89 ff. Giaccari F., *Le aggregazioni aziendali*, cit., p. 89. Cortesi A., *Le acquisizioni di imprese*, cit., p. 25. United Nations Industrial Development Organization, *Alliances and joint ventures. Patterns of internationalization for developing country enterprises*, Vienna, 2006, p. 12.

nomic subjects create a new company by contributing capital. Although the partners do hold its shares, the start-up is juridically independent. Also, the companies involved maintain their juridical identities, and their pre-joint venture assets change only in relation to the capital contributed.

The literature has delved into the issue of joint ventures and provided various definitions[111], which all share the following characteristics[112]: partners show the will to combine with one another, with the purpose of reaching a common goal in terms of profitability; and after creating the joint venture, the partners maintain their autonomy in terms of management, organisation legal status. Ventures are juridically autonomous, but the various partners exercise powers of management and control. Usually, joint venture control regulates all aspects related to the setting up of a venture, as well as the obligations and powers of the partners involved.

By setting up a joint venture, partners can carry out a common project, which is usually temporary and which can only be completed by uniting the strengths and skills of all the partners involved. Consequently, joint ventures do represent a form of partial business combination that allows for a reduction in the transaction costs typically associated with acquisitions[113], especially when the companies involved operate in different economic sectors.

Different types of joint venture might be identified in relation to various criteria[114]:

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[111] Harrigan K.R., "Joint Ventures and Competitive Strategy", *Strategic Management Journal*, 9(2), 1988, pp. 141 ff. Hennart J.R., "A Transaction Cost Theory of Joint Ventures: An Empirical Study of Japanese Subsidiaries in the United States", *Management Science*, 37, 1991, pp. 483 ff. Bamford J., Ernst D., Fubini D.G., "Launching a world-class joint venture", *Harvard Business Review,* February, 2004, pp. 90 ff. Wallace R. L., *Strategic Partnerships: An Entrepreneur's Guide to Joint Ventures and Alliances*, Kaplan Publishing, New York, 2004. Child, J., Faulkner D., Tallman S., *Strategies of Cooperation: Managing Alliances, Networks, and Joint Ventures*, Oxford University Press, Oxford, 2005. Steensma H.K., Barden J.Q., Dhanaraj C., Lyles M., Tihanyi L., "The evolution and internalization of international joint ventures in a transitioning economy", *Journal of International Business Studies,* 39(3), 2008, pp. 491 ff.

[112] Cortesi A., *La crescita delle piccole imprese*, cit., pp. 180 ff.

[113] Hennart J.F., "A Transaction Cost Theory of Equity Joint Ventures", *Strategic Management Journal*, 9, 1988, pp. 361 ff. Balakrishnan S., Koza M., "Information Asimmetry, Adverse Selection and Joint Venture: Theory and Evidence", *Journal of Economic Behaviour and Organization*, 20, 1993, pp. 99 ff. Hennart J.F., Reddy S., "The Choice between Merger/Acquisitions and Joint Ventures: the Case of Japanese Investors in the United States", *Strategic Management Journal,* 18, 1997, pp. 1 ff.

[114] Giaccari F., *Le aggregazioni aziendali*, cit., p. 89 ff.

1) on the basis of the way in which the joint venture is set up:

a) joint venture corporations: two or more companies contribute capital in order to create a new company, usually a limited company referred to as a joint venture, of which they hold the shares. By contributing capital, companies sometimes aim at increasing their stake in existing companies. Generally, such shares are given to the partners in equal parts. The founding companies maintain their economic and juridical autonomy and continue to carry out their business separately from the start-up. A joint venture corporation is aimed at establishing a long-lasting alliance, with the purpose of completing complex projects that require considerable resources and sophisticated skills; and

b) contractual joint ventures: two or more companies reach a formal deal in order to undertake a common activity. In this case, no start-up is created, but the purpose is the same as in joint venture corporations, i.e. to jointly reach a common goal;

2) on the basis of the purpose for which the joint venture is set up:

a) manufacturing joint ventures: the main goal is to generate synergies in manufacturing, in relation not only to the manufacturing system but also to hiring staff;

b) sales joint ventures: their purpose is to improve marketing and sales by reaching new markets, expanding their market share and fully exploiting the existing sales network;

c) R&D joint ventures: they are focused on basic and applied research. The former is aimed at gaining new scientific and technological skills, which pave the way for further analysis and experiments, i.e. applied research. Although such activities do not have short-term goals, they are crucial in that they allow applied research to be carried out[115]. This is aimed at reaching specific objectives in terms of products and processes by gaining technological knowledge. This will be used in the development stage to create new products;

3) on the basis of the ways in which the venture is managed and controlled:

a) independent joint ventures: these are independent from a decision-making point of view, since the partners cannot intervene in strategic and management decisions. Consequently, the venture does maintain a remarkable

[115] Puddu L., *La ricerca e sviluppo nel sistema d'impresa*, Giuffrè, Milano, 1980, p. 22 ff. Ferrata R., *Innovazione tecnologica. Politica di prodotto e strategia di diffusione,* Egea, Milano, 1989, p. 23 ff. Zanda G., Lacchini M., Onesti T., *La valutazione delle aziende*, Giappichelli, Torino, 2005, p. 233. Cricchio S., *L'impresa come momento di origine e di diffusione di fenomeni macro-economici,* cit., p. 32.

degree of autonomy in decision making;

b) jointly managed joint ventures: unlike the previous type, these ventures maintain their autonomy to a limited extent. The partners retain a right to interfere as far as strategies and management are concerned. This right is usually defined during the negotiation stage preceding the setting up of the venture;

c) controlled joint ventures: these ventures have no autonomy in decision making, in that strategies and management are dictated by the partners who manage all aspects of the venture's life.

The luxury business has often witnessed strategic alliances and joint ventures focused on manufacturing and distribution and created within the same sector or in different ones. Here follows a list of the main alliances formed in the luxury sector.

Giorgio Armani Group has always had a key role in strategic alliances. They have reached a deal with Luxottica Group, with effect from January 2013, with the purpose of manufacturing and marketing glasses and sunglasses with the brands Giorgio Armani, Emporio Armani and A/X Armani Exchange in international markets.

The Group has formed an alliance with Reebok International with the purpose of developing a new concept of activewear. Reebok have contributed their technology and innovation to appealing brands such as EA7 and Emporio Armani in sportswear and created the collections EA7/Reebok and Emporio Armani/Reebok, characterised by style, design and comfort.

Giorgio Armani has also formed strategic alliances with some important companies in the clothing industry, such as Ermenegildo Zegna for the manufacturing and distribution of Armani Collezioni and Mani Uomo; with Vestimenta, fort the first Giorgio Armani collection for men and women.

In 2010, Ermenegildo Zegna Group set up a joint venture with Reliance Brands Ltd, of Reliance Group, which is an important Indian manufacturing company. The venture, named Zegna South Asia Private Ltd, was 51% held by Ermenegildo Zegna Group and 49% held by Reliance Brands Ltd. On the one hand, Ermenegildo Zegna can take advantage of new opportunities in the Indian luxury market, use the knowledge that Reliance Retail has of the Indian market and diffuse the Zegna brand; on the other hand, Reliance Group can exploit the level of quality and innovation typically associated with Zegna products, together with the experience that the Italian group has gained in retailing luxury products. Ten new boutiques will be opened from 2010 to 2015: thanks to this, by the end of 2015, India might become the most important market in South-East Asia for Ermenegildo Zegna Group. The Indian market is undoubtedly a strategic target for the Group, which was one of the first lux-

ury companies to be established in India, following the wave of retail liberalisation promoted by the Indian government.

In 2002, Ermenegildo Zegna set up a joint venture with Salvatore Ferragamo Group. The venture, ZeFer, in which the two groups hold 50% each, was created to manage the global growth of the brand Ermenegildo Zegna in the segments of shoes and leather accessories. It is based on the manufacturing and logistics know-how of Salvatore Ferragamo Group and on the use of dedicated areas in Zegna's boutiques, as well as other deals with international distribution groups. This venture is aimed at, on the one hand, using the experience and quality level gained by Ferragamo Group and, on the other hand, taking advantage of a style that is appreciated worldwide as Zegna's. Another strategic alliance was formed by Ermenegildo Zegna with Gianni Versace for male collections.

In 2012, Canali Group created a joint venture with Genesis Luxury Fashion Private Ltd, an Indian company which distributes the brand Canali in the Indian market. The venture, which is 51% held by Canali and 49% held by Genesis Luxury Fashion Private Ltd, is aimed at marketing Canali collections in India on an exclusive basis. Prior to the deal, Genesis Luxury Fashion took care of sales in the Indian market on the basis of a distribution agreement. Through this alliance, Canali Group aims at strengthening their leadership in the Indian market of luxury garments for men, which is considered a strategic segment. For Genesis Luxury Fashion Private Ltd, this joint venture represents a further development of the business built up with Canali Group, as well as an opportunity to strengthen their brand presence in India through the opening of 10 to 15 new boutiques in the next three to four years.

In 2003, Gucci Group formed a joint venture with ND Logistics, a leading company in European transport and logistics. The venture, L.G.L. (Luxury Goods Logistics), 51% held by Gucci Group and 49% held by Norbert Dentressangle, is a cutting-edge logistics platform that takes care of all aspects of logistics for brands such as Gucci, Yves Saint Laurent, Bottega Veneta, Alexander McQueen, Balenciaga and Stella McCartney.

In 2011, Prada Group set up a joint venture with Al Tayer, an important retailer in the Arab Emirates, with the purpose of marketing the brands Prada and Miu Miu in the Persian Gulf area, especially in Bahrain, Saudi Arabia, Oman, Kuwait and in the Arab Emirates.

In order to exploit the potential of e-business, in August 2012 PPR formed a joint venture with Yoox with the purpose of creating a partnership for the on-line retailing of luxury products. The deal allows for the expertise of both players to be combined: the appeal of the brands of PPR and Yoox's expertise in managing on-line single-brand stores. The venture capital is 51% held by

PPR and 49% held by Yoox Group. Their goal is to strengthen the presence of PPR brands on the internet (Bottega Veneta, Yves Saint Laurent, Alexander McQueen, Balenciaga and Sergio Rossi) by improving the existing online stores. The on-line shops of Sergio Rossi and Bottega Veneta will be opened by the end of 2012. On-line stores are scheduled to be activated worldwide by the end of 2013. The Group might include other brands in this joint venture in the future. Each brand will manage its own on-line stores by taking care of stock, choosing web contents, outlining artistic direction and conducting digital communication. They will take advantage of the logistics platform of Yoox, which currently manages high-precision logistics in more than 100 countries, China included. The deal provides for a revenue-share model in favour of Yoox.

Luxury hotels have been associated with a number of strategic alliances. In 2010, Versace Home reached various deals with Damac Properties to build the Damac Tower in Beirut, and with Century Properties to build a 53-storey tower in Manila. Also, Missoni has entered this segment and reached a deal with the Belgian chain Rezidor Hotel Group. In 2001, Bulgari formed an alliance with Luxury Group (the luxury hotel division of Marriott) with the purpose of creating an exclusive chain of luxury hotels and resorts in the best locations and most important cities in the world; Bulgari's philosophy on contemporary luxury has been combined with the managerial skills of Ritz-Carlton. Thanks to this alliance, Bulgari has entered the hotel industry and achieved their objective of brand extension, after having achieved good results with perfumes, accessories and watches. In 2005, Giorgio Armani created Armani Hotels & Resorts by forming an alliance with Emaar Properties (real estate agents), with the purpose of building and managing luxury hotels, resorts and residences in the most exclusive locations in the world.

Also, the luxury car industry has witnessed important alliances. Ferrari has been increasing its number of stores in the Middle East. The venture, Fadar, has been developing a retail project for all Ferrari stores, not only in the Middle East but also in the Persian Gulf area. It was created by Al Fahim Enterprises (founded by the Al Fahim family, who are leaders in luxury retailing, beauty and fashion products) together with Aldar Properties (a building company that owns the Mubadala fund of the Arab Emirates Government and is one of the shareholders of Ferrari). The Ferrari stores sell clothes for men, women and children, as well as leather accessories, electronic gadgets, books, toys and memorabilia.

A number of alliances have also been formed between the fashion industry and the aircraft industry. Karl Lagerfeld, for instance, has accessorised a luxury Agusta AW139 helicopter.

Important players from the fashion and luxury yacht industries have also allied. In 2008, Hermès and Wally set up the joint venture Wally Yachts-Hermès, which built the first triangle-shaped yacht in the world, the "WHY". It is characterised by new features in shapes, volumes and performance: all under the sign of a new concept for motor-yachting.

Also, the watch industry has witnessed the creation of various joint ventures. In 2009, Ralph Lauren set up a joint venture with Richemont (held by both companies, with 50% each) with the purpose, for the former, of reaching the segment of luxury watches by exploiting the expertise and the prestige of a luxury tycoon. The latter has seized the opportunity to use the global fashion brand of Ralph Lauren.

An analysis of the strategic alliances and joint ventures mentioned shows that any form of cooperation between companies is two-fold, on the basis of the ways in which such cooperation is established[116]:

a) horizontal cooperation: cooperation is sought within one specific activity, regardless of the sectors in which the companies involved operate. This might involve competing businesses or companies manufacturing a diversified production. In both cases, the parties involved decide to cooperate in order to reach objectives that they could not easily achieve by working individually. The success of such strategies is related to the synergies created with external resources and the skills contributed by the subjects involved. The companies involved are complementary from a technical and economic point of view to an extent that usually makes it difficult to relate performances to the subjects involved[117]. Often cooperation is combined with competition[118];

b) vertical cooperation: cooperation is promoted beyond specific activities. The companies involved operate along the same supply chain, although at different stages. They are often suppliers and customers. Such cooperation is

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[116] Azzini L., *Autonomia e collaborazioni fra imprese*, Giuffré, Milano, 1964. Albertini S., *Gli accordi strategici,* cit., p. 111 ff. Quagli A., *Il comportamento strategico delle piccole imprese,* in Marchi L., Paolini A., Quagli A., *Strumenti di analisi gestionale,* Giappichelli, Torino, 1997, pp. 83 ff. Giacosa E., *L'economia delle aziende di abbigliamento*, cit., pp. 278 ff.

[117] Ferrero G., *Istituzioni di economia d'azienda*, cit., p. 69 ff.

[118] Della Corte V., Sciarelli M., *La coopetition e le scelte di governo possono rappresentare una fonte di vantaggio competitivo sostenibile per i sistemi strategici? Il caso del settore turistico,* in Maggioni V., Potito L., Viganò R., *Corporate governance: governo, controllo e struttura finanziaria,* Il Mulino, Bologna, 2009, p. 305.

similar to vertical integration[119] to a certain extent, in that companies are not complementary from a technical point of view, even though they do share an interest in reaching common goals. For instance, they might jointly carry out research in order to reduce the costs borne by each company; and

c) diagonal cooperation: the cooperation is transverse, i.e. it works both horizontally and vertically. The companies involved carry out various activities along the supply chain and operate in different sectors.

4.3.2 Subcontracting

Subcontracting is a practice related to outsourcing strategies: the management of a product is permanently assigned to a third party that might be based in the country where the company is headquartered or in a different one[120]. Subcontracting follows a make or buy decision[121]: when buying is more profitable, companies might opt for outsourcing.

Strategic alliances and subcontracting are different. In the former, the parties involved interact and cooperate permanently in order to reach a common goal in the medium/long term. In the latter, the subcontractor operates to meet the requirements of the general contractor, within a relation that might also be temporary.

Coordination between the general contractor and their subcontractors is important to the success of any subcontracting deal, in that it guarantees the control of each player in the supply chain[122]. While sourcing used to be focused on products (the best product for the cheapest price), nowadays this philosophy has changed: companies aim at providing not only products, but also services (R&D, logistics and manufacturing) together with management transparency, intensified information exchanges[123] and increased cooperation with the other players along the supply chain[124].

[119] Cesaroni F.M., *La funzione di produzione nelle piccole imprese*, Aspi, Urbino, Ins-Edit, Genova, 1997, p. 113 ff.

[120] Giacosa E., *L'economia delle aziende di abbigliamento*, cit., p. 272 ff.

[121] Fadda L., *La conoscenza dei costi nell'ambito delle decisioni aziendali*, in Fadda L., Ferrando P.M., Fontana F., Zuccardi Merli M., *Complementi di Economia Aziendale,* 2nd edition, Giappichelli, Torino, 1995, p. 175.

[122] Davis T., "Effective Supply Chain Management", *Sloan Management Review*, 34(4), 1993, pp. 35-46.

[123] O'Neal C.R., "The buyer-seller linkage in a just-in-time environment", *Journal of Purchasing and Materials Management,* 23(1), 1989, pp. 7 ff. Harrison A., Voss C., "Issues in

According to this new concept of partnership with one's subcontractors, cooperation goes beyond the exchange of goods and services and reaches the strategic level: it might entail joint developments of products, joint R&D activities and improved manufacturing systems. Such cooperation becomes more difficult to manage when subcontractors are based in far-off countries, where such interactions lose some of the advantages typically associated with subcontracting[125].

The supply chain is a key element for luxury companies, in that networks of suppliers and subcontractors need to be carefully selected and consolidated over time. For instance, in 2011, Gucci[126] prompted their strategic leather suppliers (the business of leather accessories accounts for 58% of the brand's turnover) to form alliances in an attempt to improve not only the competitiveness but also the economic and social sustainability of their business. Three business networks have thus been created in order to improve innovation in technology and organisation, cost-effectiveness, quality and safety standards. Such networks allow for greater transparency in the margin flow along the chain, so that each player can be aware of the mark-up of each subject that makes up their chain. This is aimed at avoiding low-profit subcontracting. Furthermore, in order to spread innovative management policies, Gucci is planning to diffuse the culture typical of a big multinational to its supply chain, thus fostering its growth.

The three networks are made up of 24 small and medium suppliers and subcontractors of the brand Gucci, with a total turnover of 76 million euros and 635 members of staff. Gucci sponsors the three networks by providing consultancy about organisation, technology, training and finance, with the purpose of not dispersing the excellence of the supply chain. In the area around Florence only, Gucci works with 60 suppliers and dozens of subcontractors.

Subcontracting is a common practice in the luxury sector, since it allows

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Setting up JIT Supply", *International Journal of Operations and Production Management*, 10(2), 1990, pp. 84 ff.

[124] Monczka R.M., Trent R.J., "Evolving Sourcing Strategies for the 1990s", *International Journal of Physical Distribution & Logistics Management*, 21(5), 1991, pp. 4 ff. Frey S.C., Michel M.S., "ABB and Ford: Creating Value through Cooperation", *Sloan Management Review*, Fall, 1993, pp. 65 ff.

[125] Fagan L.M., "A guide to global sourcing", *The Journal of Business Strategy*, March/April 1991, pp. 21 ff. Rinehart L.M., "Global Logistic Partnership Negotiation", *International Journal of Physical Distribution & Logistic Management*, 22(1), 1992, pp. 27 ff.

[126] Pieraccini S., "Gucci in difesa della filiera e il lusso si mette in rete", www.luxury24.ilsole24ore.com, dicembre 2011.

for higher profitability in the manufacturing process. This strategy is implemented when the general contractor does not have the skills and the manufacturing system that are necessary to undertake specific processes or the whole manufacturing process. This type of subcontracting is also defined "speciality subcontracting"[127], and it enables companies to expand their lines of products by using the skills of third parties.

In addition, subcontracting is chosen whenever the manufacturing system is momentarily unable to meet orders and its extension would be difficult to manage at a later stage, or whenever outsourcing is deemed more profitable. Specific processes are assigned to third parties, who are often standardised. Companies manage to maintain their leadership by exploiting the manufacturing potential of other businesses[128].

Subcontractors often get orders from the general contractor without having the possibility of intervening in the decision-making process. Moreover, the manufactured products can be sold only to the contractor. This generates risks for the subcontractors, which might be severely affected by a crisis of the general contractor[129]. This new approach to supply chain management poses the challenge of also involving suppliers of subcontractors, whose contribution affects the performance of suppliers[130].

Product subsystems or a whole stage of the manufacturing cycle might be outsourced. In the first case, subcontractors focus on manufacturing a product or taking care of specific processes, by complying with the specifications outlined by the general contractor; any other stage of the manufacturing process is managed by the general contractor: designing the product, making a prototype of it, acquiring raw materials (which are supplied for manufacturing purposes) and carrying out quality control. In the second case, subcontractors are commissioned to take care of various stages of the manufacturing cycle (including the acquisition of raw materials) up to the sale of products to the general contractor, which only designs the product[131]. Therefore, subcontractors are giv-

[127] Terzani S., *Controllo di gestione nelle imprese di alta moda*, Franco Angeli, Milano, 2007, p. 29. Please refer also to Cuffaro V., *La subfornitura nelle attività produttive,* Napoli, Novene, 1998. Ricciardi A., *L'outsourcing strategico: modalità operative, tecniche di controllo ed effetti sugli equilibri di gestione*, Milano, Franco Angeli, 2000.

[128] Ranalli F., *Un breve profilo della funzione commerciale*, in Cavalieri E.-Ranalli F., Economia aziendale. Vol. II. *Aree funzionali e governo aziendale*, Giappichelli, Torino, 1999, p. 77 ff.

[129] Giaccari F., *Le aggregazioni aziendali,* cit., p. 66.

[130] Nelson, A.P., Jambekar, A.N., "A Dinamic View of Vendor Relations Under JIT", *Production and Inventory Mangement Journal*, fourth quarter, 1990, pp. 65 ff.

[131] Giacosa E., *L'economia delle aziende di abbigliamento*, cit., pp. 275 ff.

en a lot of responsibility: they have to manage their own suppliers, comply with delivery times and focus on innovation and design[132].

Subcontracting is prevalent for activities characterised by low added value, i.e. activities that contribute to the value created by the company in a marginal way. On the contrary, core business activities are not outsourced: they substantially contribute to the creation of value and differentiate the company from its competitors. Activities such as product design and development, process monitoring, quality control of products not manufactured by the company and marketing are not usually outsourced. Therefore, businesses focus their skills and resources on activities with higher added value, with the purpose of increasing specialisation and obtaining economies of scale in terms of quantity, quality and time[133].

In order for products to meet the standards required, general contractors have to select their subcontractors carefully. Moreover, they have to monitor their activities through the mechanisms of trade monitoring.

Italian companies are often selected as subcontractors, especially in the fashion sector, thanks to the high levels of quality and expertise that are typically associated with Italian manufacturers. In particular, the vast majority of Italian subcontractors are based in industrial districts[134]. A district is a group of small and medium-sized companies that are commercially interrelated through both formal and informal relations. They are usually clustered in specific geographical areas[135].

Districts are pervaded by an innovation-oriented entrepreneurial culture, which is transferred from one company to the others. Such businesses operate in the same sector and are often complementary because all of them are niche oriented. They carry out a single, highly specialised stage of the manufacturing cycle, while groups allow for business integration thanks to the synergies

[132] Burt D.N., "Managing Suppliers up to Speed", *Harvard Business Review*, 67(4), 1989, pp. 127 ff. Cavinato J.L., "Evolving Procurement Organizations: Logistic Implication", *Journal of Business Logistics*, 13(1), 1991, pp. 27 ff.

[133] Caramiello C., *L'azienda. Operazioni di gestione e "dinamica dei valori*", Giuffrè, Milano, 1989, p. 11.

[134] Antonelli V., *I network system: un modello economico-aziendale,* in Antonelli V., D'Alessio R., Iuliano G., *I Network System*, Giappichelli, Torino, 2004, p. 2 ff. Camuffo A., *Caratteri strutturali ed evolutivi delle imprese tessili e dell'abbigliamento italiane,* in Camuffo A., Comacchio A., *Strategia ed organizzazione nel tessile-abbigliamento*, Cedam, Padova, 1990, p. 90 ff.

[135] Giaccari F., *Le aggregazioni aziendali,* cit., p. 71. Giacosa E., *L'economia delle aziende di abbigliamento*, cit., p. 75.

generated among the companies involved. Therefore, the manufacturing cycle is divided into stages, which are assigned to a group of district companies with the purpose of achieving higher efficiency. The fact that companies are complementary does not exclude competition, which in fact improves efficiency. It follows that districts might also be defined from a geographical point of view and by considering the relevant sector, as a group of companies and institutions that, through cooperating with external businesses (i.e. general contractors), promote higher corporate efficiency[136], as well as closer integration between the subjects involved and their context[137].

In Italy, the main industrial districts are defined on the basis of the manufacturing processes that are carried out: knitwear in Carpi and in other areas around Treviso, Vicenza, Bari and Varese; shoes on the Riviera of Brenta; wool in Prato; woollen garments for men in Biella; silk in Como; and leather accessories in Arezzo and Florence.

Through subcontracting, the general contractor gains various advantages[138]:

a) more flexible manufacturing structure: subcontracting prevents the manufacturing structure from being oversized and therefore difficult to manage at a later stage. Leaner manufacturing systems allow for flexible adaptation to changeable market needs. In other words, by using the manufacturing potential of subcontractors, companies are more flexible in satisfying human needs. This provides opportunities to improve performance and, ultimately, be more competitive;

b) higher quality: when subcontractors are carefully selected and product quality is systematically monitored, the quality level of a given line of products might be increased by exploiting the know-how and skills of subcontractors; and

c) energies are focused on core business activities, i.e. activities that contribute higher added value to the manufacturing process.

However, subcontracting might also entail some disadvantages:

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[136] Albertini S., *La gestione delle risorse umane nei distretti industriali*, Etas, Milano, 2002, p. 3.

[137] Cesaroni F., Piccaluga A. (eds.), *Distretti industriali e distretti tecnologici. Modelli possibili per il Mezzogiorno*, Franco Angeli, Milano, 2003.

[138] Catturi G. *L'azienda universale*, Cedam, Padova, 2003, p. 90. Giunta F., *La creazione di nuove imprese*, Cedam, Padova, 1993, p. 165 ff. Giacosa E., *L'economia delle aziende di abbigliamento*, cit., p. 276. Giaccari F., *Le aggregazioni aziendali*, cit., p. 66.

a) product quality might not meet specifications: when subcontractors are not closely monitored, the quality level required might not be guaranteed. In order to avoid such problems, general contractors usually employ quality control staff;

b) considerable dependency on subcontractors: the latter might hold a strong negotiation position and decide to suddenly terminate the contract. This is especially the case when subcontractors have skills that are not easily replicable and which consequently make them irreplaceable partners. In order to mitigate such risks, companies might diversify their subcontracting strategies and work with various partners, including competing ones; and

c) subcontractors might try and manufacture similar products: after having acquired key information about the manufacturing process, subcontractors might manufacture their own lines of products in an attempt to imitate the ones commissioned by the general contractor. This is highly detrimental to the image and competitiveness of any general contractor.

5
M&As in the Business of Luxury Companies

5.1 Companies Acquisitions

Acquisitions are related to companies' external growth. An acquiring company purchases a controlling stake in the share capital of another company (the acquired company), in return for a price[1]. Acquisitions might also involve a whole company or part of it through the transfer not only of shares but also of company assets (usually together with liabilities), as well as staff relocation[2].

In the case of branch acquisitions, the acquiring company purchases parts of another business company and might integrate them into its own business structure. Usually, such partial acquisitions are targeted at specific products or product systems, retailing networks, company divisions and manufacturing equipment. Such interest in a specific branch is due to the fact that it might play a strategic role within the acquiring company's business.

The strategic value made by the acquired branch is higher than the value created within the acquiring company by a similar internal activities. First, branch acquisitions enable the acquiring company to speed up the completion of a project: the acquiring company exploits an existing functioning structure. Second, branch acquisitions favour the creation of synergies between the acquiring company's business and that of the acquired company. Third, they re-

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[1] Cortesi A., *La gestione del processo d'integrazione nelle fusioni e nelle acquisizioni*, Pearson, Milano, 2008, p. 1. For details on acquisition price, please refer to: Frattini G., *Il valore di acquisizione delle imprese in funzionamento*, Giuffré, Milano, 1983. Capasso A., *Economia e finanza delle acquisizioni aziendali*, Cedam, Padova, 1990. Zanetti L., *La valutazione delle acquisizioni*, Egea, Milano, 2000.

[2] Cortesi A., *Le acquisizioni di imprese*, Egea, Milano, 2000, p. 19. Acquisitions might be carried out through various technical practices, which will not be explored in this book. For further infomration on such practices (merger through acquisition, leveraged buy out, take-over bid, aggressive take-over bid, public exchange offer, buying up, trade-in, etc.), please refer to Cortesi A., *Le acquisizioni di imprese*, cit., pp. 83 ff.

quire a smaller amount of financial resources to be invested compared to those required to purchase the whole company to which the branch belongs[3].

Through an acquisition, the acquiring company might mainly aim to own another company, without limiting its autonomy in decision making. Alternatively, acquisitions might be directed towards an integration with the acquiring company, which would affect the management autonomy of the acquired company. In the latter case, the acquisition might be followed by a merger, i.e. the technical practice through which the integration between the parties involved is formalised. Mergers do have an impact on how acquisitions are performed[4].

Mergers are extraordinary administrative acts that might result from acquisitions. Mergers refer to the combination of two or more companies to form a new one, through which the parties merged are dissolved. Consequently, the new company holds the assets and the liabilities contributed by the parties dissolved. Alternatively, a company acquiring two or more other companies, through which the acquiring company continues to exist having increased its size, while the companies acquired are dissolved[5].

Both mergers and acquisitions must not be considered as ends in themselves. On the contrary, they should be seen as means through which companies aim to reach or maintain conditions of economization. It is with a view to economization that the various steps and stages of an acquisition are completed: evaluation of the strategic problem to be solved, assessment and evaluation of alternatives between internal and external growth, choice of a specific acquisition policy, identification of acquisition candidates, outlining of the options to proceed with the acquisition, implementation of the acquisition deal and final integration. Furthermore, it would be reductive to consider

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[3] Conca V., *Le acquisizioni*, Egea, Milano, 2010, pp. 21 ff.

[4] Conca V., *Le acquisizioni*, cit., p. 25.

[5] Giaccari F., *Le aggregazioni aziendali,* Cacucci, Bari, 2003, p. 31. Cortesi A., *Le acquisizioni di imprese*, cit., p. 24. Please also refer to Amaduzzi A., *La fusione delle imprese*. *Note di economia aziendale*, Collana di Manuali di Organizzazione e Ragioneria applicata, 30, 1926. Confalonieri M., *Conferimenti e fusioni nell'economia delle imprese*, Giuffré, Milano, 1983. Galbraith C.S., Stiles C.H., "Merger Strategies as a Response to Bilateral Market Power", *Academy of Management Journal*, 27(3), 1984, pp. 511 ff. Halloran K.D., *The impact of M&A Programs on Company Identity*, Mergers & Acquisitions, Spring, 1985. Cooke T.E., *Mergers and Acquisitions*, Basic Blackwell, Oxford, 1986. Gardi F., *Fusioni ed altre combinazioni di imprese: finalità e tecniche di realizzazione*, Egea, Milano, 1990. Gualtieri P., *Le fusioni di società quotate*, Il Mulino, Bologna, 1990. Colombo G., *Fusioni, acquisizioni e scorpori*, Egea, Milano, 1992. Dezzani F., Pisoni P., Puddu L., *Fusioni, scissioni, trasformazioni e conferimenti*. *Scritture contabili*, Giuffré, Milano, 1995. Bruni G., *Fusioni & Scissioni*. *Profili economici, strategici e istituzionali*, Giuffré, Milano, 1997. Dezzani F., Dezzani L., Santini R., *Operazioni straordinarie*, Egea, Milano, 2009.

such operations only from a technical point of view. In fact, they should be evaluated from a perspective of extraordinary administration. They are administrative acts in that they entail various issues concerning management. They are extraordinary because such operations are aimed at redefining business strategies and structures, even in a radical way. It follows that acquisitions might be viable solutions to strategic problems that, in general, translate into a lack of economization[6].

In order to draw a line between acquisitions and mergers, various criteria might be used. First, on the basis of the level of integration between the companies involved[7], when compared to acquisitions, mergers show a higher level of integration. The integration resulting from a merger might impact on various aspects: initially, the manufacturing systems are combined, and then integration involves the top management. Such integration, which is not an issue in acquisitions, is particularly complex. Second, on the basis of the motives behind such operations, acquisitions are aimed at improving the acquiring company's competitive advantage through an expansion of its manufacturing mix. Mergers are carried out with the purpose of managing a new manufacturing mix resulting from the combination of those belonging to the companies involved[8].

An acquisition should be considered in relation to the strategic direction of the acquiring company[9], since it is one of many possible solutions of internal or external growth. In a strategic direction such as this, the acquiring company makes various decisions, such as where, what for and how to do business. Therefore, any acquisition policy has to be consistent with its strategic direction[10.] In some cases, however, an acquisition might be performed in order to seize a sudden change opportunity[11].

The context in which the acquired company operates is crucial when evaluating the profitability of an acquisition. The acquired company might operate

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[6] Colombo G., *Fusioni e acquisizioni: operazioni di amministrazione straordinaria*, in Rock M.L. (eds.), *Fusioni e acquisizioni. Aspetti strategici, finanziari e organizzativi*, McGraw-Hill, Milano, 1990, pp. 20 ff.

[7] Cortesi A., *Le acquisizioni di imprese*, cit., pp. 23 ff.

[8] Colombo G., *Fusioni e acquisizioni: operazioni di amministrazione straordinaria*, in Rock M.L. (eds.), cit., p. 25.

[9] Coda V., *L'orientamento strategico dell'impresa*, Utet, Torino, 1988, p. 25.

[10] Haspeslagh P.C., Jemison D.B., *La gestione delle acquisizioni*, EtasLibri, Milano, 1992, p. 17.

[11] Mitchell W., Capron L., "Managing Acquisition to Change and Survive", *European Business Forum*, 9, 2002, pp. 51 ff.

in the same sector as the acquiring company or it might operate in a different one. In both cases, the appeal of the sector[12] (in terms of development opportunities and future performance) has a considerable impact on the acquisition policies, even though such appeal can dramatically change over time. Since an acquisition allows for the rapid development of business, it also raises the possibility to exploit promptly the opportunities associated with the sector in which the acquired company operates.

Some researchers have emphasised the relation between the appeal of a sector and the post-acquisition profitability of the acquired company[13]. Such appeal is determined, on the one hand, by the growth rate of the sector in which the acquired company operates (acquisitions occur more often in sectors characterised by a high growth rate) and, on the other hand, by the level of business concentration (the lower the concentration, the more appealing the sector)[14]. Other researchers have underlined a number of strategies that allow for more profitable acquisitions[15]: for instance, the choice of the business context towards which the acquisition policies should be targeted.

The acquiring company might already be present in the strategic business unit of the acquired company or, alternatively, the acquisition might be performed in new strategic business units[16]. In the first case, the main objective

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[12] Cortesi A., *Le acquisizioni di imprese*, cit., pp. 77 ff.

[13] Hunt J.W., "Changing Pattern of Acquisition Behaviour in Takeovers and the Consequences for Acquisition Processes", *Strategic Management Journal*, 11(1), 1990, pp. 69 ff. Bleeke J., Ernst D., *Collaborating to Compete: Using Strategic Alliances and Acquisitions in the Global Marketplace*, John Wiley and Sons, New York, 1993.

[14] Schoenberg R., Reeves R., "What determines acquisition activity within an industry?", *European Management Journal*, 17(1), 1999, pp. 93 ff.

[15] Rappaport, A., "Strategic analysis for more profitable acquisitions", *Harvard Business Review*, 57, 1979, pp. 99 ff. Drucker, P.F., "The five rules of successful acquisition", *Wall Street Journal*, 15 October 1981, p. 28. Paine, F.T., Power D.J., "Merger strategy: an examination of Drucker's five rules for successful acquisitions", *Strategic Management Journal*, 5, 1984, pp. 99 ff.

[16] A strategic business unit is represented by one or more homogeneos product/market/technology combinations characterised by income responsibility. Each strategic business unit has its own economic structure as well as its own strategic management needs in relation to the competitive arena in which it operates (Coda V., *L'orientamento strategico dell'impresa,* Utet, Torino, 1988, p. 50 ff). Strategic business units might also be described as "companies within the company" or "near-companies", each of which has its own competitive system and strategic problems. Each strategic business unit pursues objectives of competitive positioning thorough the implementation of specific strategies. The criteria for evaluating a strategy can be identified only by considering every single strategic business unit (Donna G., *L'impresa competitiva. Un approccio sistemico*, Giuffrè, Milano, 1992, p. 15 ff.). The definition of a portfolio of strategic business units allows for the identification of a

for the acquiring company is to improve its competitive advantage within the context in which it operates. Such a goal is reached thanks to the specific skills that allow for the company's know-how[17] and resources to be complete; and thanks to the new position that the company has gained in its market. In the second case, the acquiring company aims at expanding its business portfolio through purchasing a company existing in a specific market. If the acquired company plays a key role in its own context, the objective of the acquiring company is to gain the leadership of that market; conversely, if the acquired company is small and has a modest market share, the acquiring company aims at exploring the new context. Besides such types, intermediate forms of acquisition are to be found, in relation to the initial situations of the acquired companies, the markets that they have reached and the motives for the acquisition[18].

5.2 Typologies and Objectives of Acquisitions

In spite of such intermediate forms, which vary in relation to the companies involved and the relevant sectors, it might be useful to classify the various types of acquisition on the basis of two criteria: commercial and productive fit between the parties involved; and difficulty of post-acquisition implementation.

The following are the main types of acquisition:

a) vertical acquisitions: the acquiring company expands in an earlier and/or later stage of its supply chain[19]; typically, it acquires one of its suppliers or one of its key customers. For instance, LVMH has purchased the French company Les Tanneries Roux, which manufactures high-quality leather for luxury com-

company's business scope. This note is taken from Giacosa E., *L'economia delle aziende di abbigliamento*, Giappichelli, Torino, 2012, p. 99.

[17] For further information about the concept of "skill", please refer to Buttignon F., *Le competenze aziendali*, Utet, Torino, 1996. Facciperi S., *Competenze distintive*, in Coda V., Invernizzi G., Rispoli M. (eds.), *Strategia aziendale*, Utet, Torino, 1998.

[18] Sales A., Mirvis P.A., *When cultures collide: Issues in acquisitions*, in Kimberly J., Quinn R.E. (eds.), *New Futures: The Challenge of Managing Corporate Transitions*, Dow Jones-Irwin, Homewood, IL, 1984, pp. 107 ff. Jemison D.B., Sitkin S.B., "Corporate acquisition: A process perspective", *Academy of Management Review*, 11(1), 1986, pp. 145 ff.

[19] Walter, G.A., *Culture collisions in mergers and acquisitions*, in Frost P.J., Moore L.R., Reis M., Lundberg C.D., Martin J., *Organizational culture* (eds.), Sage, San Francisco, 1985, p. 311. Bursi T. (eds.), *Acquisizioni e alleanze nell'industria tessile-abbigliamento*, Franco Angeli, Milano, 1992, pp. 47 ff.

panies such as Louis Vuitton, Christian Dior, Loewe, Céline and Moynat. LVMH has also purchased, together with the Koh family (the founders and majority shareholders of Heng Long International Ltd), Heng Long, i.e. one of the top five crocodile leather tanning firms in the world. Also, Chanel has purchased some of its suppliers in order to protect the excellence of their handcrafted production. Chanel currently owns nine artisanal ateliers: Montex and Maison Lesage (specialising in embroidery), Goossens (gold and silver), Massaro (shoes), A. Michael (hats), Lemarié (feathers), Desrues (buttons), Guillet (flowers) and Causse (top-quality gloves). In 2012, the Richemont Group purchased 100% of VVSA (Varin-Etampage and Varinor), a traditional supplier of components and semi-finished products for world-class watches and jewellery; the management of the acquired company will not be replaced and existing customers will also be maintained.

Vertical acquisitions require an average level of integration: the manufacturing process does not have to be jointly carried out, since the acquired company is involved in an earlier and/or later stage of the supply chain. This entails interaction, especially at the corporate level, which might cause the acquired middle managers to feel unmotivated, even more so when they consider themselves as having been "conquered"[20];

b) horizontal acquisitions: the acquired company operates in the same sector as the acquiring company and manufactures the same product or a very similar one[21]. Horizontal acquisitions take place between two companies in the same strategic business unit[22]. This was the case with the 100% acquisition of Church's by Prada in 2006. The gains from this type of acquisition may result in economies of scale (both in manufacturing and in sales), on the one hand, and in increased bargaining power with suppliers and customers, on the

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[20] Nord W.R., "Mergers make acquired executives feel inferior? You bet!", *Academy of Management Executive,* 8(2), 1994, pp. 81 ff.

[21] Salant S.W., Switzer S., Reynolds R.J., "Losses from horizontal merger: The effects of an exogenous change in industry structure on Cournot-Nash equilibrium", *The Quarterly Journal of Economics*, 98(2), 1983, pp. 185 ff. Perry M.K., Porter R.H., "Oligopoly and the incentive for horizontal merger", *American Economic Review*, 75(1), 1985, pp. 219 ff. Walter, G.A., *Culture collisions in mergers and acquisitions*, in Frost P.J., Moore L.R., Reis M., Lundberg C.D., Martin J., *Organizational culture* (eds.), cit., pp. 312 ff. Farrell, J., Shapiro C., "Horizontal mergers: An equilibrium analysis", *American Economic Review*, 80(1), 1990, pp. 107 ff. Capron L., Dussauge P., Mitchell W., "Resource Redeployment following Horizontal Acquisitions in Europe and North America, 1988-1992", *Strategic Management Journal,* 19(7), 1998, pp. 631 ff.

[22] Cortesi A., *La gestione del processo d'integrazione nelle fusioni e nelle acquisizioni*, cit., p. 4.

other[23].

Implementation efforts are considerable, inasmuch as the manufacturing process has to be carried out in synergy, duplications have to be avoided and costs have to be reduced. This may cause considerable conflicts in the management of human resources: in the acquired company, people may feel conquered and deprived of their own company values and habits; in the acquiring company, such conflicts may be because of fears of company downsizing and power abuse.

In order to mitigate such conflicts, the acquiring company has to implement communication policies under the sign of transparency, with the purpose of involving people in reaching the objectives associated with the acquisition[24]. Such communication has to be focused on the acquiring company's history, as well as on the motives for the acquisition and for the merger that might come afterwards. Those motives should be made clear to internal and external stakeholders. As a result, the communication process can be focused on how the acquisition takes place and how its consequences are managed[25]. Moreover, at least during transition, the communication process should respect the mindset of the human resources in the acquired company. When cultural differences are profound, the achievement of the planned performance might be delayed, or the operation might even fail;

c) concentric acquisitions: the acquired company manufactures a line of products in the same merchandise category as the acquiring company and uses similar technologies in its supply chain[26]. An acquisition enables the acquiring

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[23] Lorange P., Kotlarchuk E., Singh H., *Le acquisizioni: una prospettiva strategica*, in Rock M.L. (eds.), *Fusioni e acquisizioni. Aspetti strategici, finanziari e organizzativi*, cit., p. 55.

[24] Hunsaker P.L., Coombs M.W., "Mergers and acquisitions: Managing the emotional issues", *Personnel Journal*, 65(3), 1988, pp. 56 ff. Sheehy B. "Culture clash: Mergers usually fail because the numbers add up but the people don't", *Industrial Management,* 1988, 12, pp. 38 ff. Depperu D., *Il ruolo delle informazioni e delle comunicazioni nelle operazioni di fusione e acquisizione*, in Rock M.L. (eds.), *Fusioni e acquisizioni. Aspetti strategici, finanziari e organizzativi*, cit., pp. 95 ff. Cartwright S., Cooper C.L., *Mergers and acquisitions: The human factor,* Butterworth-Heineman, Oxford, 1992, p. 103. Nguyen H., Kleiner B., "The effective management of mergers", *Leadership & Organization Development Journal*, 24(8), 2003, pp. 447 ff. Want J., "When worlds collide: culture clash", *Journal of Business Strategy,* 24(4), 2003, pp. 14 ff. Appelbaum S., Gandell J., "A cross method analysis of the impact of culture and communications upon a health care merger", *Journal of Management Development*, 22(5), 2003, pp. 370 ff. Cording M., Christman P., King D., "Reducing causal ambiguity in acquisition integration: Intermediate goals as mediators of integration decisions and acquisition performance", *Academy of Management Journal*, 51(4), 2008, pp. 744 ff.

[25] Fubini D., Price C., Zollo M., *Fusioni e acquisizioni. Il ruolo della leadership*, Egea, Milano, 2008, p. 12.

[26] Cortesi A., *Le acquisizioni di imprese*, cit., p. 22.

company to enter an adjacent business, share resources and reach a correlated market, with the ultimate purpose of completing its line of products and improving its market reach. The integration process is directed at combining certain processes, usually in technology and sales, with the purpose of using the know-how and skills of the parties involved.

This might create some difficulties in implementing the acquisition, which in any case are more serious than those associated with vertical acquisitions. In concentric acquisitions, the goal is to create synergies but in a limited number of processes. For instance, LVMH has acquired several important Italian luxury companies, such as Fendi, Emilio Pucci and Acqua di Parma; PPR has purchased Brioni, Gucci, Bottega Veneta and Sergio Rossi. Through such acquisitions, the two groups have expanded their lines of products, thus entering adjoining businesses; and

d) conglomerate acquisitions: these are formed through the combination of unrelated businesses[27]: the acquiring company and the acquired company operate in different strategic business units[28]. Such operations fall within diversification strategies[29]. For instance, Richemont, the luxury group operating in the industry of jewellery and watches, has purchased the American clothing brand Peter Millar, with a view to expanding into a business other than its core business. The purpose is not sharing resources or creating manufacturing synergies: the companies involved maintain considerable autonomy in business and management, but they are also affected by cultural differences. Therefore, implementation is almost effortless. Occasionally, the management of the acquired company might be supplemented by a manager from the acquiring company: this may lead to conflicts among executives. Conglomerate acquisitions involved Korean groups (organised by business division) such as Samsung (electronics, chemicals, textiles and fashion), LG (electronics and fashion) and E.Land (food and fashion).

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[27] Mueller D.C., "The effects of conglomerate mergers: a survey of the empirical evidence", *Journal of Banking and Finance,* 1(4), 1977, pp. 315 ff. Amihud Y., Lev B., "Risk reduction as a managerial motive for conglomerate mergers", *Bell Journal of Economics,* 12(2), 1981, pp. 605 ff. Amihud Y., Dodd P., Weinstein M., "Conglomerate Mergers, Managerial Motives and Stockholder Wealth", *Journal of Banking and Finance*, 10(1), 1986, pp. 401ff. Hubbard R.G., Palia D., "A Reexamination of the Conglomerate Merger Wave in the 1960s: An Internal Capital Markets View", *Journal of Finance*, 54(3), 1999, pp. 1131 ff.

[28] Cortesi A., *La gestione del processo d'integrazione nelle fusioni e nelle acquisizioni*, cit., p. 4.

[29] Pitts R.A., "Diversification strategies and organi-zational policies of large diversified firms", *Journal of Economics and Business*, 28, 1976, pp. 181 ff. Salter M.S., Weinhold W.A., *Diversification through Acquisition: Strategies for Creating Economic Value*, Free Press, New York, 1979.

The types of acquisition so far analysed can be represented in a two-variable matrix considering the two criteria used, i.e. commercial and productive fit between the parties involved; and difficulty of post-acquisition implementation (Figure 5.1).

	Difficulties in implementation	Fit between the companies involved
Horizontal acquisition	Considerable	Considerable
Concentric acquisition	Average	Average
Vertical acquisition	Moderate	Moderate
Conglomerate acquisition	Little	Little

Figure 5.1 Types of acquisitions

Source: Personal elaboration

The objectives behind acquisitions vary in relation to the companies involved and in relation to the characteristics of the sectors in which they operate. Such objectives might be classified into the following categories[30]:

1) indirect or mediate objectives: these are inspired by motives of a higher category than direct objectives. They include: an increase in the level of economization resulting from the purchase of a functioning company and objectives involving managers, especially when their salaries are performance based. Other indirect goals are related to speculation[31], i.e. achieving capital gains. This is the case when, prior to performing the acquisition, the acquiring company identifies a purchaser to whom the acquired company will be sold, with the purpose of making a profit, i.e. the difference between the sales price and the purchase price; and

[30] Trautwein F., "Merger motives and merger prescriptions", *Strategic Management Journal,* 11(4), 1990, pp. 283 ff. Cortesi A., *Le acquisizioni di imprese*, cit., pp. 59 ff.

[31] Onida P., *Le dimensioni del capitale di impresa. Concentrazione, trasformazioni, variazioni di capitale*, Giuffré, Milano, 1944. Napier N.K., Simmons G.S., Stratton K., "Communications during a Merger: The Experience of Two Banks", *Human Resource Planning*, 12(2), 1989, pp. 105 ff.

2) direct or immediate objectives: motives belong to a lower category than indirect objectives, in that they are deeply rooted in the companies involved and are often interweaved, which makes them difficult to prioritise. Furthermore, direct objectives might depend on the kind of acquisition performed (i.e. vertical or horizontal acquisition). Some scholars have listed a number of immediate objectives, by analysing a sample of companies involved in acquisitions[32]: improved corporate image (purchases increase the visibility of the acquiring company); new positioning in the relevant business, after entering markets in which the acquired company operates, which increases opportunities of growth and development for the acquiring company; synergies created between the new skills contributed by the acquired companies and the existing skills; the know-how of the acquired companies becomes available, which is crucial when such know-how involves knowledge that is difficult to obtain; economies of scale and of scope[33] obtained through synergies in manufacturing, sales and organisation; the financial resources of the acquired company become available and allow the acquiring company to gain greater financial strength; the manufacturing systems of the companies involved are combined, which allows for more stable processes and revenue flows, especially when manufacturing cycles are seasonal and therefore fluctuating; diversification in various markets or sectors, resulting in risk mitigation; and speculation, when an under-priced acquired company has in fact good growth potential. Immediate objectives are so numerous and diverse that any attempt at creating an exhaustive list might be in vain. However, all acquisitions share motives that might usefully be classified into two macro-categories[34]:

a) first, reaching critical mass, defined as the sufficient budget level that makes it possible for a company to profitably do business. At an early stage, such critical mass equals the minimum level of investment that companies need to enter a new business and gain minimal market share. Later, it is aimed at maintaining the investment level at which the company can remain viable without having to add any more resources. When the critical mass is influenced both by the sector in which the company operates and by the character-

[32] Amihud Y., Lev B., "Risk reduction as a managerial motive for conglomerate mergers", cit., pp. 605 ff. Bradley J.W., Korn D.H., "The Changing Role of Acquisitions", The Journal of Business Strategy, 2(4), 1981, pp. 30 ff. Walter G.A., Barney J.B., "Research Notes and communications Management Objectives in Mergers and Acquisitions", *Strategic Management Journal*, 1990, 11(1), pp. 79 ff.

[33] Galassi G., *Concentrazioni e cooperazioni interaziendali*, Giuffré, Milano, 1969.

[34] Colombo G., *Fusioni e acquisizioni: operazioni di amministrazione straordinaria*, in Rock M.L. (eds.), *Fusioni e acquisizioni. Aspetti strategici, finanziari e organizzativi*, cit., pp. 25 ff.

istics of the company itself, acquisitions might usefully be aimed at reaching and/or maintaining optimal conditions in terms of critical mass; and

b) second, seeking synergies[35]: acquisitions allow for synergies if, when sharing resources, the players involved need fewer resources to reach the same performance in terms of quality and quantity than when working individually. Alternatively, synergies might result in improved quality and quantity performance, while using the same amount of resources. Synergies are not an automatic consequence of acquisitions: comparing the value chains of the companies involved is crucial to evaluate the advantages of an acquisition and, ultimately, to assess synergy opportunities. Synergies might be sought both between companies operating at the same stage in the supply chain (such as when Nike acquired Umbro) or between companies operating at different stages in the supply chain (such as when Luxottica acquired a sales network in South America).

Such synergies might be classified in different categories[36] within the various business functions. Here follows an analysis of the characteristic businesss functions[37]:

a) R&D: the most crucial synergies result from M&As with highly innovative companies, with whom highly competitive networks might be created[38]. An innovative partner brings benefits to the acquiring company: first, it stimulates innovation-driven policies; secondly, it helps in coping with competitors. In horizontal acquisitions, innovation-driven partnerships are aimed at improving the quality of new lines of products. In vertical acquisitions, synergies have an impact on the quality of the supply system and/or on the marketing and sales strategies. Another crucial synergy occurs in the opportunity of ac-

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[35] Chatterjee S. “Types of synergy and economic value: the impact of acquisitions on merging and rival firms”, *Strategic Management Journal*, 7(2), 1986, pp. 119 ff.

[36] Capasso A., Meglio O., *Fusioni e acquisizioni. Teorie, metodi, esperienze*, FrancoAngeli, Milano, 2009, pp. 87 ff. Gruca T.S., Nath D., Mehara A., “Exploiting Synergy for Competitive Advantage”, *Long Range Planning*, 30(4), 1997, pp. 605 ff.

[37] The characteristic business functions are those which closely mirror the object and the scope of business. They make up the “core business” of a company (Ferrero G., *Impresa e Management*, Giuffré, Milano, 1987, p. 179), since they pursue the business objectives in a direct way. The core business might be described as the management operations that identify a company’s economic and technical functions (Airoldi G., Brunetti G., Coda V., *Corso di Economia aziendale*, Il Mulino, Bologna, 1989, p. 71).

[38] Gerpott T.J., “Succesful Integration of R&D Functions after Acquisitions: An Exploratory Empirical Study”, *R&D Management,* 25(2), 1995, pp. 161 ff.

quiring and developing new technologies, especially when the acquired company is niche oriented, highly innovative and makes available its know-how[39]. Innovation is a key element when choosing a partner: M&As might often be performed and internal growth given up because the latter would require too long a time for innovation to be achieved or it might not be successful. In some cases, M&As are deemed better than licensing, since the latter might not lead to meeting the required standards of quality and innovation;

b) manufacturing and logistics: the integration process between the parties involved is aimed at decreasing costs of production, improving cost-effectiveness and obtaining economies of scale and of scope. In the case of horizontal integration, increased bargaining power might result in better conditions of supply, together with reduced stock levels required for manufacturing purposes. Besides, manufacturing synergies enable a company to reach its optimal size without making its structure less flexible. In the case of vertical integration, better supply conditions derive from the acquisition of suppliers; moreover, technological synergies might be created when the companies involved share similar technological traits;

c) marketing: synergies between companies might lead to gaining greater market share in existing contexts and entering new markets. Furthermore, the new company might expand its line of products, thanks to the skills contributed by the companies involved. In addition, previously unexploited individual skills might be used and enhanced through cooperation. Last but not least, through brand extension policies, a company's brand might be employed in the markets in which the other companies operate, thereby increasing opportunities for customer satisfaction; and

d) organisation and human resources: the management of human resources is rather complex, since each and every decision related to downsizing, staff relocation or redundancy has a considerable impact on the company atmosphere and affects the business context. Synergies have to promote organisational compatibility between companies in terms of tasks, roles and responsibilities. In particular, they involve aspects such as training, the allocation of tasks and the enhancement of staff at various hierarchy levels. Synergies should be directed at motivating and incentivising staff towards any new com-

[39] Ahuja G., Katila R., "Technological Acquisitions and the Innovation Performance of Acquiring Firms: A Longitudinal Study", *Strategic Management Journal,* 22(3), 2001, pp. 197 ff. Hagedoorn J., Duysters G., "The Effect of Mergers and Acquisitions on the Technological Performance of Companies in a High-tech Environment", *Technology Analysis & Strategic Management,* 14(1), 2002, pp. 67 ff. Bannert V., Tschirky H., "Integration Planning for Technology Intensive Acquisitions", *R&D Management,* 34(5), 2004, pp. 481 ff. Meglio O., "Measuring Performance in Technology-Driven M&As: Insights From a Literature Review", *Advances in Mergers and Acquisitions*, 8, 2009, pp. 103 ff.

pany project.

Synergies must be sought in a rational way and to a reasonable extent; otherwise, disadvantages might outnumber advantages and, as a consequence, the company might become weaker. This is especially true when considering that the new company has to be able to improve its performance after such synergies start to decline[40].

5.3 Mergers & Acquisitions (M&As)

In spite of the differences in form and content between mergers and acquisitions, the international literature refers jointly to these operations as "mergers and acquisitions" (M&As)[41]. These operations are considered complementary and defined with the one phrase "merger and acquisition" [42]. This is not the case in Italian literature, where mergers and acquisitions are considered to be two different kinds of operation.

Some authors describe M&As as important strategies of external growth through which companies increase their size[43]. This is especially true for mature sectors, where internal growth becomes more difficult, or for companies in which internal growth would be excessively time consuming. The literature

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[40] Coda V., *Prefazione all'edizione italiana*, in Fubini D., Price C., Zollo M., *Fusioni e acquisizioni. Il ruolo della leadership*, cit., p. VIII.

[41] Bastien D., "Common Patterns of Behaviour and Communication in Corporate Mergers and Acquisitions", *Human Resource Management*, 26(1), 1987, pp. 17 ff. Barney J.B., "Returns to Bidding Firms in Mergers and Acquisitions: Reconsidering the Relatedness Hypotesis", *Strategic Management Journal*, 9, 1988, pp. 71 ff. Rock M.L. (eds.), *M&A Planning Models*, McGraw-Hill, New York, 1987. Buono A.F., Bowditch J.L., *The Human Side of Mergers and Acquisitions. Managing Collision Between People, Cultures and Organisations*, Jossey-Bass Publishers, San Francisco-London, 1989. Hitt M., King D., Krishnan H., Makri M., Schijven M., Shimizu K., Zhu H., Mergers and Acquisitions: Overcoming Pitfalls, Building Synergy, and Creating Value, *Business Horizons*, 52(6), 2009, pp. 523 ff. Appelbaum S.H., Roberts S., Shapiro B.T., "Cultural Strategies in M&As: Investigating Ten Case Studies", *Journal of Executive Education*, 8(1), 2009, pp. 33 ff.

[42] Gaughan P.A., *Mergers and Acquisitions*, Harper & Collins, New York, 1991.

[43] Cartwright S., Cooper C.L., "The role of culture compatibility in successful organisations", cit., pp. 57 ff. Belcher T., Nail, L., "Integration problems and turnaround strategies in a cross-border merger, a clinical examination of the Pharmacia-Upjohn merger", *International Review of Financial Analysis,* 9(2), 2000, pp. 219 ff. Hitt M.A., Harrison J.S., Ireland R.D., *Mergers and Acquisitions: A Guide to Creating Value For Stakeholders*, Oxford University Press, Oxford, 2001. Cartwright S., Schoenberg R., "Thirty Years of Mergers and Acquisitions Research: Recent Advances and Future Opportunities", *British Journal of Management*, 17(S1), 2006, pp. S1 ff.

has emphasised the strategic importance of M&As in terms of competitive edge[44].

On the basis of the kind of substantial and formal agreement reached between the players involved, M&As might be classified in the following categories[45]:

a) friendly agreements: M&As are performed through an agreement between the players; such an agreement might result from previous cooperation or from objectives leading to a mutually advantageous situation; and

b) hostile operations: M&As might consist of attacks on the shareholders or might pose a threat to the management. They may be gradually or immediately performed.

Such a distinction is not always clear cut. Sometimes acquisitions can start as hostile operations and be turned into more or less friendly agreements at a later stage, in order to mitigate damage to weaker players.

The motives for both friendly agreements and hostile operations might be various, given the specific situation of each company. Nevertheless, such motives might share commercial objectives (i.e. taking advantage of the competitive position of the acquired company) or size objectives (i.e. expanding in order for the acquiring company to obtain economies of scale and of scope). Moreover, the acquiring company might aim at exploiting the knowledge and skills of the acquired company, especially when such knowledge and skills cannot be easily replicated. It might also be driven by defence strategies, with the purpose of responding to competitors' moves or creating barriers to entry in the markets in which it operates. The acquiring company may also aim at exploiting external factors that might create new business opportunities. Last but not least, the acquiring company might be left with no alternative other than a merger or an acquisition in order to enter a new market or gain greater market share. This is the case when markets are very mature and the only way to improve market reach is to purchase a company that operates in the relevant market(s).

M&As have considerably grown in number: this is due to the fact that the context has greatly changed, forcing companies to pursue external growth in

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[44] Amit R., Shoemaker P.J.H., "Strategic assets and organizational rent", *Strategic Management Journal,* 14(1), 1993, pp. 33 ff. Teece D.J., Pisano G., Shuen A., "Dynamic capabilities and strategic management", *Strategic Management Journal*, 18(7), 1997, pp. 509 ff. Giaccari F., *Le aggregazioni aziendali*, cit., p. 46.

[45] Conca V., *Le acquisizioni*, cit., pp. 28 ff.

order to cope with competitors. Given the importance of this phenomenon, the literature has focused on analysing the performance obtained from M&As[46]. Some researchers have emphasised the difficulties in reaching the financial objectives planned[47]. According to some scholars, the new company is not worth more than when the two businesses were apart[48].

Besides external reasons, such as the impact of the global crisis and changes in the relevant sector, a number of internal reasons have been identified by the literature that account for the failure of M&As. One of the main reasons for failure is the inability of the management to manage the new company[49]. This deficiency is determined, among other factors, by the inexperience that the management has in coping with similar situations[50]. The management might fail to devise an appropriate competitive strategy when evaluating the acquired companies and the synergies actually obtainable with the

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[46] Datta D.K., "Organizational fit and acquisition performance: effects of post-acquisition integration", *Strategic Management Journal*, 12(4), 1991, pp. 281 ff. Palich L.E., Cardinal L.B., Miller C.C., "Curvilinearity in the diversification-performance linkage: An examination of over three decades of research", *Strategic Management Journal,* 21(2), 2000, pp. 155 ff. Hitt M. A., Harrison J.S., Ireland R., *Mergers and acquisitions: A guide to creating value for stakeholders*, Oxford University Press, Oxford, 2001. King D.R., Dalton D.R., Daily C.M., Covin, J.G., "Meta-analyses of post-acquisition performance: Indications of unidentified moderators", *Strategic Management Journal,* 25(2), 2004, pp. 187 ff. Cloodt M., Hagedoorn J., Van Kranenburg H., "Mergers and acquisitions: Their effect on the innovative performance of companies in high-tech industries", *Research Policy,* 35(5), 2006, pp. 642 ff.

[47] Lubatkin M., "Mergers and the peformance of the acquiring firm", *Academy of Management Review*, 8(2), 1983, pp. 218 ff. Cartwright S., Cooper C.L., "The role of culture compatibility in successful organizational marriage", *The Academy of Management Executive,* 7(2), 1993, pp. 57 ff. Carleton R.J., "Cultural due diligence", *Training*, 34, 1997, pp. 67 ff.

[48] Mirvis P.H., Marks M.L., "The Human Side of Merger Planning: Assessing and Analyzing "Fit"", *Human Resource Planning*, 15(3), 1992, pp. 69 ff. Hitt M.A., Harrison J.S., Ireland R., *Mergers and acquisitions: A guide to creating value for stakeholders*, cit.

[49] Cartwright S., Cooper C.L., *HR Know-how in Mergers and Acquisitions*, Institute of Personnel and Development, London, 2002. Lin B.W., Shih-Chang Hung S.H., Li P.C., "Mergers and acquisitions as a human resource strategy, evidence from US banking firms", *International Journal of Manpower,* 27(2), 2006, pp. 126 ff. Haleblian J., Kim J., Rajagopalan N. "The influence of acquisition experience and performance on acquisition behavior: Evidence from the U.S. commercial banking industry", *Academy of Management Journal,* 49(2), 2006, pp. 357 ff.

[50] Barkema H.G., Bell J.H.J., Pennings J.M., "Foreign entry, cultural barriers, and learning", *Strategic Management Journal*, 17(2), 1996, pp. 151 ff. Hayward M.L.A., "When do firms learn from their acquisition experience? Evidence from 1990-1995", *Strategic Management Journal,* 23(1), 2002, pp. 21 ff. Barkema H.G., Schijven M., "How do firms learn to make acquisitions? A review of past research and an agenda for the future", *Journal of Management,* 34(3), 2008, pp. 594 ff.

operation[51]. This ultimately causes wealth to be destroyed[52]. Furthermore, the management might be more interested in increasing share price and forget that the company's mission is to satisfy human needs (and not create value for shareholders). Therefore, leadership becomes crucial[53]: the management should be prepared to cope with various situations in full respect of a shared vision[54]. In order to do so, they should commit to promoting growth, helping the companies involved in making the transition to the new situation, adopting a humble attitude towards the human resources of the acquired company and putting aside pointless fights for power[55].

It is true that, on the one hand, integration requires mutual respect for cultural differences; on the other hand, however, it is only by bearing in mind the common goals that the process can be successful. The management must aim at reaching both strategic and organisational fit[56], which might be usefully analysed through the cultural web model[57]. This model is helpful in evaluating fit

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[51] Hayward M.L.A., Hambrick D., "Explaining the premiums paid for large acquisitions: Evidence of CEO hubris", *Administrative Science Quarterly*, 42(1), 1997, pp. 103 ff. Zanetti L., *La valutazione delle acquisizioni*, cit. Guatri L., Bini M., *Nuovo trattato sulla valutazione delle aziende*, Università Bocconi, Milano, 2005.

[52] Sirower M.L., *The Sinergy Trap: How Companies Lose the Acquisition Game*, Free Press, New York, 1997.

[53] Smith J.E., Carson K.P., Alexander R.A.. "Leadership: it can make a difference", *Academy of Management Journal*, 27(4), 1984, pp. 765 ff. Kotter J.P., *Leading Change*, Harvard Business School Press, Boston, 1996. Covin J., Kilmann R., "Participant Perceptions of Positive and Negative Influences on large-scale change", *Group and Organisational Studies*, 15(2), 1990, pp. 233 ff. Jick T.D., " Implementing Change", *Harvard Business School*, 3, 1991, pp. 192 ff. Cummings T.G., Worley, G.G., *Organisational Development & Change*, 8th Edition, South Western College Publishing, Ohio, 2005. O'Reilly C.A. III, Chatman J., Caldwell D.F., "People and organizational culture: a profile comparison approach to assessing person-organisation fit", *Academy of Management Journal*, 34, 1991, pp. 487 ff. Covin T.J., Kolenko T.A., Sightler K.W., Tudor R.K., "Leadership style and post-merger satisfaction", *Journal of Management Development,* 16(1), 1997, pp. 22 ff. Bijlsma-Frankema K, "On managing cultural integration and cultural change processes in mergers and acquisitions", *Journal of European Industrial Training*, 25(2/3/4), 2001, pp. 192 ff. Want J., "When worlds collide: culture clash", cit., pp. 14-21. Appelbaum S., Shapiro B., "Mergers 101 (part one): Training managers for communications and leadership", *Industrial and Commercial Training*, 39(3), 2007, pp. 128 ff.

[54] Haspeslagh P.C., Jemison D.B., *La gestione delle acquisizioni*, cit., p. 19.

[55] Coda V., *Prefazione all'edizione italiana*, in Fubini D., Price C., Zollo M., *Fusioni e acquisizioni. Il ruolo della leadership*, Egea, Milano, 2008.

[56] Colombo G., *Fusioni e acquisizioni: operazioni di amministrazione straordinaria*, in Rock M.L. (eds.), cit., p. 19.

[57] Giacometti E., Clarke C.J., "Acquisire con successo", *L'impresa*, 3, 1987.

through a number of dimensions or symptoms of compatibility, such as the average age of the board of directors, the ratio of bonuses to salaries and the number of levels in the organisation. Such a model shows that profound differences between companies might cause integration problems.

Also, the size of the new company is deemed a critical factor, in that it might affect the outcomes of M&As: the bigger the company, the more difficult it is to obtain economies of scale and of scope[58]. An incongruous post-acquisition increase in size might cause diseconomies, resulting in increased unit costs of production, increased bureaucratisation and decreased cost-effectiveness[59].

Since the size factor is a crucial element in acquisitions[60], the literature has focused on it and has defined the ideal size at which the benefits outweigh the costs due to the diseconomies resulting from the higher complexity associated to a larger company. Some researchers have identified the ideal size on the basis of the ratio of the assets of the acquired company to the assets of the acquiring company, evaluated in the year preceding the acquisition[61]. Some scholars have maintained that, when the acquisition target is a big company, it is more likely that value will increase. This is related to the possibility of exploiting the financial resources of the acquired company while obtaining considerable economies of scale[62].

The literature has not yet identified *the* ideal post-acquisition size. No evidence has been found of any connection between the size and the performance of the acquiring company[63]. In fact, a sort of crushing of the acquired company

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[58] King D.R., Slotegraaf R., Kesner I., "Performance implications of firm resource interactions in the acquisition of R&D-intensive firms", *Organization Science,* 19(2), 2008, pp. 327 ff.

[59] Bertini U., *Scritti di Politica Aziendale*, Giappichelli, Torino, 1990.

[60] Onida P., *Le dimensioni del capitale di impresa. Concentrazione, trasformazioni, variazioni di capitale*, cit. Zappa G., *Le produzioni nell'economia delle imprese*, Giuffré, Milano, 1957. Corticelli R., *La crescita dell'azienda. Armonie e disarmonie di gestione*, Giuffré, Milano, 1979. Corticelli R., *La crescita dell'azienda. Ordine ed equilibrio nell'unità produttiva*, Giuffré, Milano, 1998. Cortesi A., *Le acquisizioni di imprese*, cit., pp. 107 ff.

[61] Kusewitt J.B. Jr., "An Exploratory Study of Strategic Acquisition Factors Relating to Performance", *Strategic Management Journal*, 6(2), 1985, pp. 151 ff.

[62] Shelton L.M., "Strategic Business Fits and Corporate Acquisitions. Empirical Evidence", *Strategic Management Journal*, 9(3), 1988, pp. 279 ff. Fowler K.L., Schmidt D.R., "Post Acquisition Financial Performance and Executive Compensation", *Strategic Management Journal,* 11(7), 1990, pp. 559 ff.

[63] Newbold G.D., Stray S.J., Wilson K.W., "Shareholders Interests and Acquisition Activity", *Accounting and Business Research*, vol. 23, 1976, pp. 201 ff.

might translate into worse working conditions, due to unmotivated and depressed staff. In addition, it has been proven that the performance of the acquired company tends to decline dramatically when the acquired company is much smaller than the acquiring company. This fact is detrimental to the image and to the distinctive skills of the acquired company.

Another reason why M&As fail lies in the cultural differences between the contexts involved[64]: some cultural features are so elusive that they are said to have an impact "at a preconscious level"[65]. The effects of M&As have been analysed and included under the umbrella term of "M&A syndrome" (Figure 5.3); reactions and responses might vary on the basis of the ages, roles, tasks, attitudes and personalities of the human resources involved. Typical reactions might be positive or negative and they often vary over time, especially after a careful evaluation of any new circumstance is made. Among the negative reactions are rage, worry, demotivation, stress and anxiety about the future; among the positive reactions are interest, commitment and acceptance[66]. The wider the range of positive reactions, the higher the degree of commitment in the new company there is; this favours the success of the operation. In order to cope with the cultural variable, the management must adopt a cross-cultural

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[64] Buono A.F., Bowditch J.L., Lewis J.W.III, "When Cultures Collide: The anatomy of a Merger", *Human Relations*, 38(5), 1985, pp. 477 ff. Cartwright S., Cooper C.L., *Mergers and acquisitions: The human factor,* Butterworth-Heineman, Oxford, 1992, pp. 58 ff. Nahavandi A., Malekzadeh A.R., *Organizational culture in the management of mergers*, Quorum Books, Westport, 1993, p. 19. Davis S.M., *Managing corporate culture,* Ballinger, Cambridge, 1994, pp. 2 ff. Horwitz F.M., Anderssen K., Bezuidenhout A., Cohen S., Kirsten F., Mosoeunyane K., Smith N., Thole, K., Van Heerden A., "Due diligence neglected: managing human resources and organizational culture in mergers and acquisitions", *South African Journal of Business Management*, 33(1), 2002, pp. 1 ff. Lodorfos G., Boateng A., "The role of culture in the merger and acquisition process. Evidence from the European chemical industry", *Management Decision*, 44(10), 2006, pp. 1405 ff.

[65] Sathe V., *Culture and related corporate realities,* Richard D. Irwin, Homewood, 1985, p. 30.

[66] Sinetar M., "Mergers, morale, and productivity", *Personnel Journal,* 60(November), 1981, pp. 863 ff. Schweiger D.L., Ivancevich J.M., "Human resources: The forgotten factor in mergers and acquisitions", *Personnel Administrator,* 30(November), 1985, pp. 47 ff. Hunsaker P.L., Coombs M.W., "Mergers and acquisitions: Managing the emotional issues", cit., pp. 56 ff. Chatman J.A., Jehn K.A., "Assessing the relationship between industry characteristics and organisational culture: how different can you be?", *Academy of Management Journal*, 37(3), 1994, pp. 522 ff. Cartwright S., Cooper C.L., "The human effects of mergers and acquisitions", *Journal of Organizational Behavior*, 1, 1994, pp. 47 ff. Schraeder M., Self D., "Enhancing the success of mergers and acquisitions: An organizational culture perspective", *Management Decision*, 41(5), 2003, pp. 511 ff. Stahl G.K., Voigt A., "Impact of Cultural Differences on Merger and Acquisition Performance: a Critical Research Review and an Integrative Model", *Advances in Mergers and Acquisitions*, 4, 2004, pp. 51 ff.

approach focused on the cultural differences between the companies involved, as well as on the need for acculturation processes[67].

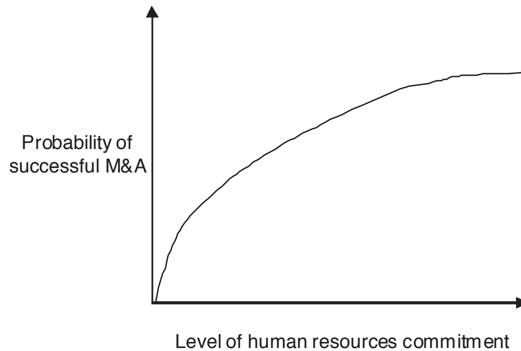

Figure 5.2 M&A Syndrome

Source: Personal elaboration

5.4 M&As in the Luxury Market

M&As are frequently performed in the luxury business with the purpose of achieving external growth. The players might be differently combined in the roles of the acquiring company and the acquired company. As far as the acquired company is concerned, the player might own a well-established brand or, alternatively, might be an extremely specialised small company (typically when a former supplier is acquired).

As far as the acquiring company is concerned, the player is usually a large multi-brand and multi-product group that performs M&As in order to enlarge its line of products. Such large groups often pursue external growth by purchasing other brands: the brand is the key element of its competitive strategies. The purpose is the creation of a diverse brand portfolio allowing for the fame and identity of each brand to be used, and for opportunities for diversification from

[67] Burke R.J., *The human side of mergers and acquisitions: managing collisions between people and organizations*, Jossey Bass., San Francisco, 1987. Colombo G., *Fusioni e acquisizioni: operazioni di amministrazione straordinaria*, in Rock M.L. (eds.), *Fusioni e acquisizioni. Aspetti strategici, finanziari e organizzativi*, McGraw-Hill, Milano, 1990, pp. 18 ff.

core business[68]. A brand extension is often performed: in other words, the brand is extended to other merchandise categories with the purpose of providing the consumer with a wide range of products with which they can satisfy various everyday needs. Such products are all associated with the brand or with a number of brands. When businesses decide to unify the merchandise categories while diversifying the levels of price, they have to constantly "re-differentiate"[69], in order to come out with forms of differentiation different from those of their competitors.

This strategy of brand extension might create some confusion, in that the prices imposed by the company for the different types of products vary according to the product features, thus becoming either luxury prices, premium prices or mass prices: borders between products are not very clear cut for consumers. This problem might be avoided through the identification of ultra-premium products within a line of products. For instance, Armani S.p.A. has diverse lines of products: prestigious tailor-made garments for selected customers (such as an actress who commissions an evening dress for the Oscar ceremony, or an aristocrat who does the same for her wedding), mass-produced luxury collections (i.e. the lines Giorgio Armani and Armani Privé), premium lines (Emporio Armani and Armani Jeans) and medium-end lines of accessories with a licensed brand (such as glasses).

However, the acquiring firm might also be a non-luxury company. Such a strategy is successful provided the management is able to change their frame of mind: the luxury business should be considered as "an island" on which the consumer's perception works as a *trait d'union* of various attributes, both material and immaterial, which are beyond the product's functions. The attitude has to be the same as that of the management of a non-luxury company when launching its own top-end brand: the operation is successful on the condition that the luxury line is considered as a unique thing, with attributes other than those characterising mass products. Of course, each synergy might result in economies of scale (especially in terms of R&D and human resources management) that are to be sought whenever the advantages gained are not detrimental to the brand image. For instance, Ford decided to acquire Jaguar with the purpose of entering the luxury business. Premier Automotive Group was consequently created and a number of both luxury brands (such as Jaguar and Aston Martin) and premium brands (Volvo) were purchased. Premier Automotive Group did not manage to generate profits and Ford decided to give up luxury

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[68] Carcano L., Rovetta B., "Strategia multi-brand per i beni simbolici", *Economia & Management*, 5, 2009, p. 62 ff.

[69] Kapferer J.N., Bastien V., *Luxury Strategy*, FrancoAngeli, Milano, 2009, p. 67.

cars. The problems were probably due to the fact that Ford did not fully understand the dynamics governing the luxury business and failed to adapt its own strategies to the new target.

The various strategies of external growth within M&As in the luxury business might be classified on the basis of two characteristics of the acquiring company[70]: the number of brands owned and its brand extension (Figure 5.3).

BRAND		MERCHANDISE CATEGORIES: *Single merchandise category*	MERCHANDISE CATEGORIES: *Several merchandise categories*
	Multi-brand	Brands are integrated in one merchandise category	Brands are integrated in a number of merchandise categories
	Single brand	Single brand in one merchandise category (niche companies)	Single brand extended to a number of merchandise categories

Figure 5.3 Brand strategies within M&As

Source: Personal elaboration

These can be described as follows[71]:

1) companies operating in one merchandise category with one brand: this strategy is often adopted by small businesses that operate in market niches, for instance a winery whose wines are considered luxury products and are well known abroad. Typically, when such a winery performs M&As, the target company is another winery. After the operation, the acquiring winery continues to operate with its own brand, since it is well known in the market;

2) companies operating with two or more brands in one merchandise category: this strategy is typically followed by groups that perform important M&As, resulting in the control of several brands focused on one merchandise category. M&As are directed at purchasing businesses that operate in the same merchandise category as the acquiring company, which maintains the acquired

[70] Giacosa E., Culasso F., Mazzoleni A., "Fashion System: The Case of Italy", *World Journal of Social Sciences*, 2(3), 2012, pp. 212.

[71] Giacosa E., *L'economia della aziende di abbigliamento*, cit., pp. 6 ff., p. 91, pp. 314 ff.

brand and exploits it from a commercial point of view. The group Richemont is a good example. It operates in the industry of watches and jewellery with several well-known brands, such as Cartier, Piaget, Van Cleef & Arpels, IWC, Vacheron Constantin, Baume & Mercier, Panerai, Jaeger-LeCoultre and Montblanc;

3) companies operating with two or more brands in different merchandise categories: this strategy is implemented by large multi-brand, multi-product groups, which aim at creating a diverse brand portfolio while operating in various sectors. LVMH, PPR, Prada Group and Tod's Group are good examples. The brands might be positioned at the same price level (LVMH Group, for instance, operates in the luxury business with a number of well-known brands) or at different price levels (Giorgio Armani owns, besides luxury brands, brands such as Emporio Armani and Armani Jeans that are positioned at lower price levels); and

4) companies operating with one brand in different merchandise categories: this is a strategy of brand extension for a diverse range of products, aimed at diffusing the brand values while offering customers a total look that can satisfy their various needs[72]. A sort of "marquee"[73] is therefore created, under which a brand extends its presence to various merchandise categories and offers a whole lifestyle[74], thereby enabling the customer to satisfy all of his or her needs. The acquiring firm manages an "umbrella brand"[75], i.e. it controls a brand portfolio. Fashion companies such as, among others, Versace, Armani and Fendi use their brands for garments, shoes, bags, accessories and interior design goods. The luxury business provides a plethora of examples of brands that have pursued growth by exploring different contexts: Fendi was established as a furrier, Gucci and Louis Vuitton started business in leather accessories and Chanel originally dealt with haute couture. Some of their lines remain central, i.e. they are symbolic of the brand, while others might be seen as peripheral, since they are not essential in defining the brand identity and can be marketed not only in dedicated boutiques. For Cartier, for instance, watches

[72] Mariotti J., *Smart Things to Know About Brands & Branding*, Capstone, Milford, 1999, p. 148. Keller K.L., *Strategic Brand Management. Building, Measuring and Managing Brand Equity,* Prentice Hall, Upple Saddle River, 2003, pp. 581 ff. Busacca B., *Le strategie di brand extension: l'attivazione del valore-potenzialità della marca,* in Vicari S. (eds.), *Brand Equity. Il potenziale generativo della fiducia*, Egea, Milano, 1995. Busacca B., Keller Lane K., Ostillio M.C., *La gestione del brand*, Egea, Milano, 2005, p. 337 ff.

[73] Klein N., *No logo. Economia globale e nuova contestazione*, Baldini & Castoldi, Milano, 2002, p. 150.

[74] Okonkwo U., *Luxury Fashion Branding*, Palgrave, Macmillan, New York, 2007, p. 139.

[75] Randall G., *Branding*, Kogan Page, London, 1997, p. 17.

and jewellery are central, while leather accessories and glasses are peripheral lines.

In the following section, the fourth scenario is further explored, since brand extension in various merchandise categories is a very common practice in the luxury business.

Businesses choose brand stretching when they realise that, in a luxury company, the brand translates into capital[76]. The fame of the brand is exploited in other contexts and the brand itself outgrows the product[77], thus conveying a message regardless of the products with which it is associated. It follows that such an "eponymous brand"[78] might be applied to various merchandise categories while maintaining its identity.

In order for this strategy to be successful, the new products have to match the customer's perceptions. In other words, consumers should consider the brand's extension to other products as a legitimate move and should realise that the brand identity has not been distorted in the process (this is the case with the brand Versace, whose elegance perfectly fits with interior design). If customers accept the new products, the company has reached its goal; when the existing line of products is innovative, this also contributes to success. This does not translate into repetitiveness when creating new lines of products. In fact, it is crucial that companies remain consistent with their distinctive values.

Businesses might implement brand extensions in different ways. First, depending on the merchandise category of the new product[79], they might resort to:

a) category extension: the new product belongs to a merchandise category that is not part of the core business. Fendi, for instance, extended its brand from fur coats to garments, accessories, interior design, etc.; or

b) line extension: the new product belongs to the merchandise category in

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[76] Kapferer J.N., *Les marques. Capital de l'Enterprise,* Editions d'Organization, Paris, 2000, p. 280.

[77] Fabris G., Minestroni L., *Valore e valori della marca*, cit., p. 159. Gabrielli V., *Il brand,* Il Mulino, Bologna, 2012, p. 37.

[78] Ellwood I., *The essential brand book. Over 100 techniques to increase bran value*, Kogan Page, London, 2000, pp. 19 ff.

[79] Cappellari R., *Il marketing della moda e del lusso*, cit., p. 70. Giacosa E., *L'economia della aziende di abbigliamento*, cit., p. 314.

which the company operates, although in a new market segment[80]. Dior, for example, has created a kids collection in addition to its line of womenswear.

Brand extensions are performed with various purposes[81], such as increasing turnover while providing loyal customers with new opportunities to satisfy their needs. Moreover, through brand stretching, companies can save the financial resources that would have to be invested in creating or purchasing a new brand. They can also succeed in risk diversification, since any expansion of a line of products translates into risk mitigation. Fendi is, once again, a good example: by the time the demand for fur coats started to decline, the company had already performed brand extension. Brand stretching might also be achieved through licensing, which favours business growth without requiring further investments and know-how.

Secondly, depending on price, companies might perform brand extension through the following practices[82]:

a) vertical practices: companies expand their lines of products either by decreasing or increasing the prices of new products. When lowering prices, companies aim to attract new customers, especially "day trippers" (i.e. occasional purchasers of luxury products). Armani, for instance, offers haute couture, *prêt-à-porter* and more affordable lines and accessories, some of which are licensed. When performing brand extension through lower prices, companies aim at guaranteeing brand recognisability by implementing various strategies: focus on the product's intrinsic value, packaging and facing; aggressive communication and great care in designing stores. Furthermore, core products are usually pushed upwards with the purpose of making the gap between top-end and accessible items wider.

On the contrary, when increasing prices, companies aim at creating a finer line of products than existing ones, with the purpose of differentiating themselves from their competitors. American Express, for instance, launched Centurion, an exclusive credit card for clients who are introduced by a selected group of Platinum credit card holders. Profitability might change from one

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[80] AA.VV., *Harward Business Review on Brand Management*, Harward Business School Press, Harvard, 1991, p. 105 ff. As far as line extension strategies are concerned, please also refer to Ellwood I., *The essential brand book. Over 100 techniques to increase brand value*, cit. Sherrington M., *Added value. The alchemy of brand-led growth*, Palgrave Macmillan, New York, 2003.

[81] Keller K.L., *Strategic brand management. Building, measuring and managing brand equity*, cit., pp. 581 ff.

[82] Kapferer J.N., Bastien V., *Luxury Strategy*, cit., pp. 180 ff.

product to another: some are considered as secondary items, in that they create lower profits; however, they are maintained in order to diffuse the brand (the average gross profit for a bag is about 75%). If luxury brands could be positioned on a scale, companies that perform vertical extensions would move them upward and downward, in the attempt to satisfy the needs of top-end target consumers; and

b) horizontal practices: businesses expand their lines of products without reducing prices, with the purpose of providing loyal customers with new opportunities to satisfy their needs. Brands remain crucial, since they convey the values towards which products should be directed. Therefore, each line of products becomes a sort of universe including various merchandise categories at a certain price level (the same within each category), all of which share the same amount of exclusivity associated with the brand. Ralph Lauren, for instance, has performed horizontal extension on garments, accessories, make-up, perfume, interior design, restaurants and cafés. In such cases, the purpose is not to differentiate variously exclusive sub-brands but to emphasise the values associated with the main brand on any purchase occasion.

Brand extension doubtlessly translates into a number of advantages[83]. First, it allows for rapid growth without requiring large investment; however, it requires considerable brand equity, which assists in driving customers towards the new merchandise categories. In other words, brands are considered as potential value multipliers[84]. The inclusion of more affordable products (such as perfume and glasses) together with a successful advertising campaign can result in greater customer awareness and satisfaction. Wider market reach ultimately results in increased turnover.

Secondly, when brand extension involves accessories, these herald the brand image, which greatly benefits from the fact that accessories display the brand logo. Accessories might work as a decoy and attract potential customers into a boutique: once there, they might be so engrossed by the brand universe that they not only purchase accessories but also other kinds of products.

Thirdly, barriers to entry might be created, resulting in competitors having to cope with a well-established brand on a variety of products. Last but not least, brand extension translates into economies of scale and of scope[85]: the

[83] Keller K.L., *Strategic brand management. Building, measuring and managing brand equity*, Prentice Hall, Upple Saddle River, 2003, p. 581 ff. Giacosa E., *L'economia della aziende di abbigliamento*, cit., p. 315.

[84] Mariotti J., *Smart things to know about brands & branding*, cit., p. 148.

[85] Scannerini A.L., *Le strategie di diversificazione nelle imprese di alta moda*, Dami, Pistoia, 2000, p. 46.

former are obtained, for instance, when a clothing company manufacturing menswear decides to extend to womenswear; the latter are obtained when a company uses the same resources to manufacture a number of products, thus allocating the costs related to various functions (such as R&D, logistics and retailing) to different items.

Besides these advantages, brand extension might also translate into several disadvantages. For example, the combination of strengths typically associated with luxury companies, i.e. creativity, excellence and exclusivity, might "lose its grip"[86]. This happens when a brand is extended to segments or merchandise categories that are not consistent with its values or when it is excessively "diluted" because of overexposure[87]. Brand extension might not be accompanied by adequate elasticity of the brand's goodwill: this would cause customer trust to plummet. When the quality of the new products is not consistent with the corporate brand personality, consumers tend to reject them[88]. The risk of damaging the brand image might be mitigated by offering highly creative products and by distributing them in a selective way (for instance, in limited editions). When the brand image is damaged, brands suffer from a stretching effect[89], i.e. they are detrimentally distanced from their core values. This was the case with Pierre Cardin, which abandoned the specialisation attitudes originally associated with its brand, thus losing allure and prestige[90].

Furthermore, all creative and productive aspects must be closely monitored, especially when manufacturing is outsourced, so that each and every product might successfully herald the brand in the market. With the same purpose, large fashion companies choose not to lower their prices under a certain

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[86] Roedder J.D., Loken B., "Diluting brand beliefs: when do brand extensions have a negative impact?", *Journal of Marketing*, 58, 1993, pp. 71 ff. Sherrington M., *Added Value. The Alchemy of Brand-Led Growth*, cit., pp. 74 ff. Kotler P., Marketing Management. Analysis Planning, Implementation and Controll, Prentice-Hall, New York, pp. 641 ff. Kapferer J.N., Bastien V., *Luxury Strategy*, FrancoAngeli, Milano, 2009, p. 182.

[87] Aaker D.A., *Brand equity. La gestione del valore della marca*, Francoangeli, Milano, 1997, pp. 297 ff. Leuthesser L., *Defining, Measuring and Managing Brand Equity*, Marketing Science Institute, Cambridge, 1988. Aaker D.A., Joachimsthaler E., *Brand leadership*, cit., p. 183. Reddy S.K., Holak S., Bhat S., "To Extend or not to Extend: Success Determinants of Line Extensions", *Journal of Marketing Research*, 31(2), 1994, pp. 243 ff.

[88] Ellwood I., *The essential brand book. Over 100 techniques to increase brand value*, cit., pp. 28 ff.

[89] Sherrington M., *Added value. The alchemy of brand-led growth*, cit., p. 74 ff.

[90] Ellwood I., *The essential brand book. Over 100 techniques to increase bran value*, cit., p. 37. Ries A., Ries L., *The 22 Immutable Laws of Branding. How to Build a Product or Service in to a World-Class Brand*, Harper Business, New York, 2002, p. 51.

limit, even though they often perform brand extensions towards accessories, in order not to lose brand allure. Chanel, for instance, sells its simplest and most casual bags for no less than 1,000 euros. Armani, in a similar way, consistently protects its brand image (in spite of its various lines, from haute couture to casual clothes) by keeping such lines separate and by distributing them through different channels.

Licence monitoring is also crucial, since licensees tend to pursue their own profit rather than brand development. From the point of view of manufacturing, such monitoring is essential in all cases of outsourcing where there is no contact between the creative team and the production line.

When pursuing brand extension, companies might opt to outsource[91] certain stages of the manufacturing cycle or might commission semi-finished products or components from third parties[92]. Undoubtedly, such choices bring various advantages. First, companies achieve higher elasticity and flexibility in coping with changeable market demand, because they do not have to make investments that would increase their structural rigidity and they can remedy structural deficiencies in the manufacturing system[93]. Second, businesses have more opportunities to change their lines of products promptly without bearing any extra cost. However, outsourcing also involves the risk of companies becoming sheer intermediaries between manufacturers and customers, since they do not physically manufacture the products[94].

Companies might outsource the whole manufacturing process, or part of it, to a country where labour costs are lower, either in company-owned premises or in factories belonging to third parties. Businesses usually outsource standardised labour activities with low added value and low innovation content with the purpose of increasing profitability. However, outsourcing might damage the unique cultural traditions associated with a product: manufacturing a luxury product in a context other than its own may damage its allure, in that customers might miss part of the dream of purchasing a product that has been manufactured in the right place.

Moreover, outsourcing may deprive a product of its geographical identity, which results from the use of raw materials coming from the context where the product itself is manufactured (such as handmade embroidery from Bruges). In addition, outsourcing might extend manufacturing and delivery

[91] Giacosa E., *L'economia della aziende di abbigliamento*, cit., pp. 249 ff.

[92] Farneti G., *Economia d'Azienda*, cit., p. 33.

[93] Cesaroni F.M., *La funzione di produzione nelle piccole imprese*, cit., p. 108. Melis G., *Elementi di Economia d'Azienda*, cit., p. 132

[94] Giacosa E., *L'economia della aziende di abbigliamento*, cit., pp. 249 ff.

times, consequently delaying restocking. Last but not least, it does not allow companies to monitor product quality.

5.4 M&A Trends in the Luxury Business

In 2011, the number of worldwide M&As in fashion and in the luxury business decreased by 33%, with 91 operations performed (137 in 2010; 149 in 2007), which is accounted for by the global crisis. In spite of such reduction, the quality of M&As has increased: for instance, the French group LVMH purchased Bulgari, a historic brand that produces top-end Italian jewellery, together with Ole Henriksen (make-up) and ArteCad (watches). PPR, another French giant of the luxury business, purchased Brioni (an Italian clothing company), Volcom (specialising in action sports; PPR has therefore gained a stronger position in this new segment), Sowind (produces top-end Swiss watches such as Girard-Perregaux and JeanRichard), Wilderness Safaris (a South African company specialising in environmentally friendly luxury tourism) and Cobra (manufacturers of golf equipment).

As far as the acquiring companies are concerned, private equity funds play a leading role, having performed 18 M&As (20% of the total number of M&As), followed by apparel companies (16), retailing companies (15), private investors (10) and large luxury groups (9). From a geographical point of view, 30 M&As were performed between Italian companies (acting either as acquiring or acquired companies), 7 were targeted at foreign companies by Italian firms, 15 were targeted at Italian companies by foreign firms and 39 were performed between foreign companies[95].

Foreign investors have shown considerable interest in the Italian luxury sector: 16% of the M&As performed in 2011 were targeted at Italian companies by foreign firms (15 M&As). Such Italian businesses are characterised by the excellent quality of their products; some of them own historic world-class brands[96]. On the one hand, this phenomenon testifies to the exclusivity of Italian brands; on the other hand, it carries the risk of eroding the Italian prestige in the luxury business.

LVMH and PPR have been the two keenest purchasers of Italian businesses. LVMH has acquired Bulgari, thus achieving an extremely rich brand portfolio (including, among others, Fendi, Emilio Pucci and Acqua di Parma). Several financial newspapers have defined LVMH and Bulgari as “the perfect

[95] Pambianconews, Febraury 2012.

[96] www.moda24.ilsole24ore.com

couple" from a strategic point of view: thanks to this operation, LVMH not only doubled the turnover of its jewellery and watches division but also gained greater market reach in Europe, Asia and the United States. PPR has added Brioni to its other brands such as Gucci, Bottega Veneta and Sergio Rossi.

Besides the two French groups, other foreign players have directed their attention to Italian luxury companies: for instance, the Austrian group Labelux has gained control of Belstaff; Paris Group (Arab Emirates) has acquired Gianfranco Ferré; the Chinese company Shandong Heavy has purchased Ferretti Group Yacht; and the Arab fund Mubadala has acquired 40% of Ballantyne.

Abroad, Labelux has purchased the brand Jimmy Choo (luxury shoes) from the English private equity fund Towerbrook; Jean-Paul Gaultier has been acquired by the Spanish company Puig.

In 2011, some Italian businesses played the role of acquiring company in a number of M&As. For instance, Luxottica (a leader in designing, manufacturing and marketing top-end, luxury and casual glasses) performed various important operations, which resulted in the creation of considerable value. Luxottica has achieved a good track record by focusing on small-scale M&As (in comparison with the acquisition of Oakley in 2007). By implementing a sun belt strategy aimed at improving its market reach in the segment of sunglasses, Luxottica has become stronger both in South America and in some European markets. In particular, Luxottica purchased 100% of Tecnol Group (Brazilian eyewear leader), 470 stores in South America (Chile, Peru, Ecuador and Colombia) and two Mexican chains specialising in sunglasses (High Tech and Stanza), which own more than 70 stores.

Also, 2012 has witnessed a large number of M&As targeted at Italian fashion and luxury brands. In particular, some companies that are still owned by the founding family are considered extremely appealing targets, thanks to their considerable brand equity: Ermenegildo Zegna (turnover of 1.1 billion euros in 2011), Giorgio Armani (about 1.6 billion), Tod's (893.6 million), Ferragamo (986.5 million), Versace (292.3 million), Pomellato (140 million) and Cavalli (178 million).

In the role of the acquiring company, a number of Italian businesses might play a key role in international markets, thanks to the good performances achieved after entering the stock exchange: Prada, for instance, was listed on the Hong Kong Stock Exchange in 2011; Salvatore Ferragamo was listed on the Milan Stock Exchange in the same year. Luxottica has purchased from Multiopticas Internacional a chain of 120 stores specialising in sunglasses throughout Spain. Safilo has acquired Polaroid Eyewear, which is not only the

world leader in technology for polarised lenses and optics but also the owner of several world-class brands.

Groups headquartered in the Far East and in emerging countries, which can account for considerable financial resources and sell their products in booming markets, have shown a keen interest in Italian businesses, thus becoming competitors of LVMH and PPR. Valentino Fashion Group has been purchased by Mayhoola for Investments (a financial holding company based in Qatar and owned by Sheik Hamad bin Khalifa Al Thani, a majority shareholder in Tiffany) from Red & Black, a Luxembourg company owned by London-based private equity fund Permira (80%) and by members of the Marzotto family (20%). Thanks to this acquisition, Mayhoola for Investments now owns the brand Valentino and the licence for M Missoni.

In addition to a number of M&As in the fashion industry, the royally funded Qatar investment authority (Qia) has recently performed other important operations in Europe. In Italy, for instance, it has purchased Costa Smeralda Holding (which owns land, four luxury hotels, the marina and the docks in Porto Cervo, a golf club in Pevero), together with Hotel Gallia in Milan. In Germany, it has a share in the car manufacturing group Volkswagen (which, in turn, controls luxury brands Audi and Lamborghini). In the United Kingdom, the royal fund owns 100% of Harrods; in France it has a share in LVMH and 100% of the Paris Saint-Germain football team.

The French brand Vionnet has been acquired by London-based Go To Enterprise Sarl, owned by Kazak businesswoman Gaukhar Erkinova Berkalieva, with the purpose of extending the brand in the Balkan area and in former USSR countries. A total of 80% of the French fashion house Sonia Rykiel has been purchased by Fung Brands, a Chinese group based in Hong Kong: this could lead to the international development of the French brand, especially in Asian markets.

Concerning the most important M&As performed in the luxury business in 2011 and 2012, the following remarks might be made.

M&As performed by Italian companies acting as acquiring companies have been characterised by a strategic approach to internationalisation. When targeting companies based in countries where labour costs are lower, their goal was not only to improve cost-effectiveness; they were also seeking business partners with whom synergies could be created, in terms of manufacturing and sales. The acquired companies were often highly innovative and specialised and/or niche companies relying on a well-established brand and efficient retailing networks.

When the role of the acquiring company was played by foreign businesses, these were often large multinational groups that were trying to create a diverse

brand portfolio, i.e. extending to more than one sector or productive segment, such as LVMH, PPR and Richemont. M&As were focused either on one price category (e.g. luxury products) or on different price categories for various customer segments. When the target company was an Italian firm, the key element was the "made in Italy" factor, i.e. a mix of creativity, manufacturing excellence, quality and good taste, especially for French and American investors. The acquiring company was often a royal fund, which is a symptom of the fact that power is shifting[97] from mature economies to the Middle East and Asia.

Summarising the motives behind the numerous M&As mentioned would be an extremely difficult task. However, it is possible to outline some of their general features. From the perspective of the acquiring company, such "merger mania"[98] in the luxury business has been characterised by the following objectives:

a) increase in size: the synergies created in manufacturing, sales and organisation have an accelerating effect on external growth. This is possible thanks to the exploitation of each partner's skills, productive capacity, sales potential, brand and market reach. Acquisition strategies fit particularly well in mature markets, which might otherwise be difficult and expensive to penetrate or further explore;

b) expansion of business scope from a geographical point of view: by using the sales network of the acquired company, the acquiring firm might be able to expand its business scope. Markets offer new opportunities: more and more customers can be attracted and lines of products can be expanded. The target markets are often the same as those in which the acquiring company is based or mainly operates;

c) acquisition of an appealing well-established brand: brands are certainly one of the appealing elements for acquiring companies. In case the acquired company owns a well-established world-class brand, the acquiring company might decide to be consistent with the values traditionally associated with the brand, in order to not damage its identity. Therefore, the acquiring company tries to combine the look and values of the acquired brand with a more modern vision of it. When the acquired company owns a luxury brand, each and every product that is marketed with that same brand acquires the allure of a luxury product. In other cases, the acquired brand needs to be re-launched into the market: the financial resources and skills of the acquiring company give new

[97] KPMG, *20 anni di M&A*, Egea, Milano, 2010, p. 34.

[98] Pambianco C., *I signori dello stile*, Sperling & Kupfer, Milano, 2008, p. 173 ff.

appeal to the brand and enhance its growth perspectives. This happened when LVMH purchased Emilio Pucci and when Gucci Group acquired Yves Saint Laurent. Another possible scenario is that of an emerging brand being acquired and developed thanks to the resources of the acquiring company: this is the case with the brand Stella McCartney, which was bought by Gucci Group;

d) brand extension to several merchandise categories: when the acquiring company owns a well-established luxury brand, it might be interested in extending this brand to various merchandise categories. Therefore, the target might be a small firm that is capable of manufacturing high-quality products that match the appeal of the brand. Brand extensions might occur in the business unit where the acquiring company operates or in a different business unit. In the first case, the company aims at strengthening its role in the business unit; in the second case, the ultimate goal is diversification;

e) creation of synergies: since the companies involved share their skills and know-how, synergies are created and cost-effectiveness is improved in manufacturing, sales and organisation. Moreover, business risks are spread between the companies involved. Lines of products might be expanded and sales increased by using the skills and know-how of the partner, thus avoiding investments that would make the company structure more rigid; and

f) control of the supply chain: in vertical acquisitions, the purpose of the company is to defend its competitive advantage, through cooperation with or management of the other players in the chain. By doing so, the acquiring company is able to maintain direct control of supply channels and target markets.

From the perspective of the acquired company, M&As have a positive influence in terms of manufacturing, sales, organisation and performance. Thanks to the financial resources of the acquiring company, new investments might be made to develop new ideas or to strengthen the brand. By combining the acquiring company's skills and know-how with those of the acquired company, the latter might improve the manufacturing process and expand its scope. Furthermore, the managerial skills of the partner might increase the profitability of the acquired company, especially when the latter is in a situation of financial crisis and needs fresh management skills to achieve normality.

Such advantages are counterbalanced by a number of disadvantages. Acquired companies often lose their autonomy in decision making, especially when the acquiring company has a very different managerial culture. This can be detrimental to the company atmosphere, in that both the creative team and the management team no longer feel free to create and manage what used to

be *their* own company. Finally, when the acquiring company belongs to a different sector, the integration process might be more difficult because of the inability of the acquiring company to grasp the dynamics of the sector in which the acquired company operates.

5.5 The Integration Process

Integration follows acquisitions performed with a view to external growth. It is a process through which two or more companies aim at sharing their competitive advantage[99], with the ultimate purpose of creating a sort of osmosis between them[100]. Thanks to an interactive consecutive process, people who work there learn to successfully work together and cooperate in transferring and sharing skills and resources[101]. In other words, integration is the process through which the companies involved in an acquisition work together in order to create value[102].

Such advantages result from the use of and combination with the partner's

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[99] A competitive advantage might result from:

- cost leadership: companies are capable of developing the same business activities as their competitors while bearing lower costs;

- differentiation-based leadership: companies stand out in respect to competitors along the whole value chain;

- leadership of focus: companies pursue increasing specialisation in order to meet specific customer needs.

Porter M., *Il vantaggio competitivo*, Edizioni di Comunità, Milano, 1987, p. 17 ff. Porter M., *The competitive advantage of nations*, Free Press, New York, 1991. Rappaport A., *La strategia del valore*, Franco Angeli, Milano, 1989, p. 115. Donna G., *La valutazione economica delle strategie aziendali*, Giuffrè, Milano, 1992, p. 168. Donna G., *L'impresa competitiva. Un approccio sistemico*, cit., p. 27 ff. Caldarelli A., *ABM e Benchmarking*, Giappichelli, Torino, 2003, p. 9. Russo P. (eds.), *Le strategie competitive di base*, in Brunetti G., Coda V., Favotto F., *Analisi, previsioni, simulazioni economico-finanziarie d'impresa*, Etas, Milano, 1999, p. 134 ff. Corbetta G. (eds.), *La gestione strategica*, in Brunetti G.-Coda V.-Favotto F., Analisi, previsioni, simulazioni economico-finanziarie d'impresa, Etas, Milano, 1999, p. 77. This note is taken from Giacosa E., *L'economia delle aziende di abbigliamento*, cit., pp. 7 ff.

[100] Franck G., "Mergers and Acquisitions: Competitive Advantage and Cultural Fit", *European Management Journal*, 8(1), 1990, pp. 40 ff. Shrivastava P., "Post-merger integration", *The Journal of Business Strategy*, 7(1), 1986, pp. 65 ff.

[101] Cortesi A., *La gestione del processo d'integrazione nelle fusioni e nelle acquisizioni*, cit., p. 22.

[102] Haspeslagh P.C., Jemison D.B., *La gestione delle acquisizioni*, cit., p. 141.

manufacturing system, skills and know-how, with the purpose of developing the acquiring company's potential. It follows that the competitive advantage deriving from a successful integration is higher than the sum of the competitive advantages contributed by the companies involved and evaluated prior to the integration[103]. Therefore, integration creates conditions that favour value creation[104].

Not all acquisitions require a process of integration. Integration takes place only when the management aims at achieving advantages that depend on the level of cooperation reached by the companies involved. At the end of such processes, the companies might merge, i.e. the acquired company is taken over by the acquiring company, or the businesses are dissolved and a new company is formed.

Integration does not take place when the acquiring company performs acquisition in order to achieve capital control of the acquired company, without creating any synergies (e.g. acquisitions performed by institutional investors; purchases of minority shares[105]).

Integration not only involves a physical exchange of resources; in fact, it affects company habits and it significantly influences internal processes. It requires considerable efforts in terms of interaction between the people who work for the companies involved[106]: in the manufacturing process, when interaction is directed at transferring skills and know-how; in the administrative processes, when interaction is focused on the development of information and control systems; and at a symbolic level, when interaction is aimed at persuading the acquired company that the beliefs, ideas and behaviour of the acquiring company are viable. Last but not least, integration requires people to be involved: the staff that, at various levels, work for the company must adapt to renewed work procedures and be engaged in the new company project.

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[103] Fazzini M., *Aggregazioni, accordi e alleanze tra imprese,* cit., p. 7. Giacosa E., *L'economia delle aziende di abbigliamento*, cit., p. 262.

[104] Barringer B.R., Harrison J.S., "Walking a tightrop: creating value through interorganizational relationships", *Journal of Management*, 26(3), 2000, pp. 367 ff. MacDonald R., "A template for shareholder value creation on M&As", *Strategic Direction*, 21(5), 2005, pp. 3 ff. As far as value creation is concerned, please refer to (among others): Guatri L., *La teoria di creazione del valore. Una via europea,* Egea, Milano, 1991, p. 7. Guatri L., Vicari S., *Sistemi d'impresa e capitalismi a confronto. Creazione di valore in diversi contesti,* Egea, Milano, 1994. Donna G., *La creazione di valore nella gestione dell'impresa,* Carocci, Roma, 1999, pp. 37 ff. Rappaport A., *La strategia del valore. Le nuove regole della performance aziendale,* Franco Angeli, Milano, 1997. Russo P., *Decisioni aziendali e valore dell'impresa,* Egea, Milano, 2000

[105] Conca V., *Le acquisizioni*, cit., pp. 199 ff.

[106] Haspeslagh P.C., Jemison D.B., *La gestione delle acquisizioni*, cit., pp. 156 ff.

In order for integration to be successful, the exchange of distinctive qualities, skills and know-how is crucial, in that it avoids integration being imposed on the acquired company[107]. Therefore, integration is a challenge first and foremost for the managing directors: when two companies merge, the process might have an impact on their health more than any other event in their business life[108]. Every delayed or wrong move in the integration process (i.e. delayed strategic decisions, counterproductive compromises, and contradictory inbound/outbound information and communication flows) might have devastating consequences on all aspects of company management[109].

Any integration process reflects a resource-based view[110]: the acquiring company aims at achieving control of the resources and skills of the acquired company, which are often quite difficult to find on the market. Adequate exploitation of resources and know-how assists in achieving a competitive advantage. Furthermore, proper management of the acquired resources might result in the creation of further resources, which might in turn strengthen the competitive advantage.

The literature has focused on the importance of properly managing post-merger integration in order to achieve value creation[111]. Such integration should not be considered as a simple automatic incremental practice subsequent to external growth. In fact, it is a very delicate stage in a company's life: post-merger integration that is not properly dealt with might cause M&As to fail[112]. It requires considerable integration efforts to identify cultural, management and organisational differences and to turn them into opportunities, while

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[107] Cortesi A., *Le acquisizioni di imprese*, cit., p. 192.

[108] Fubini D., Price C., Zollo M., *Fusioni e acquisizioni*. *Il ruolo della leadership*, cit., p. 8.

[109] Fubini D., Price C., Zollo M., *Fusioni e acquisizioni*. *Il ruolo della leadership*, cit., p. 21.

[110] Wernerfelt B., "A Resource Based View of the Firm", *Strategic Management Journal*, 5(2), 1984, pp. 171 ff. Prahalad C., Hamel G., "The Core Competence of the Corporation", *Harvard Business Review,* May-June, 1990, 68(3), pp. 79 ff.

[111] Haspeslagh P.C., Jemison D.B., *Managing Acquisitions*. *Creating Value Through Corporate Renewal*, The Free Press, New York, 1991. Meglio O., "Processi di integrazione post-acquisizione e creazione del valore: aspetti economici, sociali e integration capability", *Finanza, Marketing e Produzione*, 1, 2002, pp. 39 ff. Meglio O., *Il processo di integrazione post-acquisizione,* Cedam, Padova, 2004.

[112] Searby F.W., "Control Post-merger Change", *Harvard Business Review*, September-October, 1969, pp. 4 ff. Allen M.G., Oliver A.R., Schwallie E.H., "The Key to Successful Acquisitions", *The Journal of Business Strategy*, 2(2), 1981, pp. 14 ff. Kaplan S.N., Weisbach M.S., "The success of acquisitions: Evidence from divestitures", *Journal of Finance,* 47(1), 1992, pp. 107 ff. Galpin T.J., Robinson D.E., "Merger Integration: the Ultimate Change Management Challenge", *Mergers & Acquisitions*, January-Febraury, 31, 1997, pp. 24 ff.

avoiding hostility and stress[113].

Post-merger integration might be considered as a crucial phase in value creation, i.e. an absolutely critical stage following M&As[114].

In order to achieve successful integration, various key factors should be taken into consideration: the strategic interdependence to be reached between the companies involved and their organisational autonomy. On the basis of how these factors combine with each another, the integration process might take place in different ways. The possible approaches are[115]:

a) the absorption approach: when the companies involved operate in a similar context, the level of interdependence to be reached is quite high, at the expense of organisational autonomy. This kind of integration is aimed at obtaining significant economies of scale and of scope, thanks to the thorough unification of activities, organisational structures, cultural variables, manufacturing systems and sales networks. The ultimate goals are the creation of synergies and the elimination of all kinds of barriers between the businesses involved, which thus become one efficient company. Integration might be quite complex, especially when the companies involved are of the same size: in such cases, it is crucial for the acquiring company to behave in a very convincing way and to implement communication strategies under the sign of transparency. A high level of interdependence might create some confusion regarding where one company ends and the other starts: this may generate stress and discontent in the management of the acquired company, in that they would like to maintain their autonomy;

b) the preservation approach: the companies involved maintain their organisational autonomy and independently manage a number of activities, except

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[113] As for the handling of cultural, management and organisational differences is concerned, please refer to: Rock M.L. (eds.), *Fusioni e acquisizioni. Aspetti strategici, finanziari, organizzativi*, McGraw-Hill, Milano, 1990. Faulkner D., *International Strategic Alliances*, McGraw-Hill, Milano, 1995. Pivato S., Gilardoni A., *Elementi di economia e gestione delle imprese*, Egea, Milano, 2000.

[114] Shrivastava P., "Post-merger integration", cit., pp. 65 ff. Habeck M.M., Kröger F., Träm M.R., After the merger - seven rules for successful post-merger integration, Pearson Education Limited, Edinburgh, 2000.

[115] Cortesi A., *Le acquisizioni di imprese*, cit., pp. 193 ff. Howell R.A., "Plan to Integrate Your Acquisitions", *Harvard Business Review*, November-December, 1970, pp. 66 ff. Haspeslagh P.C., Jemison D.B., *La gestione delle acquisizioni,* cit., pp. 180 ff. Ashkenas R.N., De Monaco L.J., Francis S.C., "Making the Deal Real: How GE Capital Integrates Acquisitions", *Harvard Business Review*, January-Febraury, 1998, 76(1), pp. 165 ff.

for those that might be efficiently managed when concentrated in few hands, such as the top management, the management of cash flows and the management of financial risks. Integration takes place with a view to preserving the unique characteristics of each company involved. In cases where such characteristics are not maintained, the performances of the businesses involved could decline, and the benefits deriving from the acquired company would ultimately be lost. Such preservation might favour learning attitudes in the acquiring company, in terms of skills, know-how and managerial attitudes; and

c) the symbiosis approach: integration is based on a combination of interdependency and organisational autonomy. In a first stage, the companies operate autonomously while maintaining their functional independence and distinctive features. In a later stage, more intense synergies might profitably be created. The barriers between companies become less and less impenetrable and synergies result in better performance. Ultimately, the mutual exchange of skills and know-how is strongly favoured. This kind of integration is the most difficult to perform: the management has to take company borders into consideration and favour symbiosis at the same time.

The integration process will be explained in detail by the following topics:

a) critical factors of integration process;
b) integration process stages;
c) horizontal integration;
d) vertical integration.

5.6.1 Critical Factors of Integration Process

The critical factors that determine the success of an integration process are various: their combination enables integration scenarios to be efficiently managed[116]. Such factors must be dealt with in an interactive and consecutive way, with no factor prevailing over the others. The main critical factors are[117] (Figure 5.4):

a) cultural and organisational differences: the cultural and organisational context of the acquired company might be significantly different from that of the acquiring company. The context is made up of the individual traits, motivations and aspirations of the people who work for the company, together with

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[116] Von Krogh G., Sinatra A., Singh H., *The Management of Corporate Acquisitions. International Perspective*, Basingstoke, Macmillan Press, 1994. Epstein M.J., “The Drivers of Success in Post-Merger Integration”, *Organizational Dynamics,* 33(2), 2004, pp. 174 ff.

[117] Conca V., *Le acquisizioni*, cit., pp. 205 ff.

the skills and know-how that they possess, as well as personal and hierarchical-organisational behaviours. The cultural features of the acquired company cannot be easily obliterated because they are the result of lengthy processes. Therefore, integration should be aimed at making such features complementary to those of the acquiring company, with the ultimate purpose of making it easier for the latter to adapt to the new context. The best results do not occur when one contexts prevails over the other[118], as some cultural traits might be worth being preserved, even if only to a certain extent. However, when the cultural features of the acquired company are outstandingly successful, they should be maintained, or otherwise part of the competitive advantage would be lost.

Cultural fit is crucial for the acquired company to maintain motivation and commitment to the new company project. The performance of the companies involved is determined not only by organisational variables but also by the level of compatibility of the information systems, especially the accounting and management ones. In order to make such systems more compatible, any opposition has to be mitigated: people who are used to certain company practices might be reluctant to adopt new procedures. Another controversial issue is related to top management integration: leadership definition plays a key role in the success of the operation, in that it prevents the new company from becoming a very powerful car driven by an unsuitable or incapable driver.

Top managers should become the driving force of business success: time and energies should be devoted to favour integration between the top managers of the acquiring company and those of the acquired company; roles and responsibilities should be clearly defined. When coping with problems related to the cultural and organisational contexts, the management should not lack flexibility[119], i.e. they should not stick to the original motives of the operation when the actual situation is rather different from the intended scenario. Strong leadership would assist in reaching such goals by defining any new post-merger objectives;

b) consensus: the higher the level of integration, the higher the need to achieve a consensus, which reaches its highest level of importance in the cases of mergers. In order to reach a consensus, it is necessary to create a positive participatory atmosphere for the staff of the companies involved. In other words, the staff of the acquired company should be motivated, stimulated and rewarded; the staff of the acquiring company should not feel threatened.

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[118] Fubini D., Price C., Zollo M., *Fusioni e acquisizioni. Il ruolo della leadership*, cit., p. 14.

[119] Haspeslagh P.C., Jemison D.B., *La gestione delle acquisizioni*, cit., p. 161.

Therefore, effective communication strategies should be implemented in order to successfully outline the post-merger objectives. A consensus is easier to reach if the companies involved promote pre-merger cooperation, thus creating a positive atmosphere of mutual respect and trust.

A consensus should not only be considered from an internal point of view; the management should also protect[120] external stakeholders, i.e. customers, commercial partners and the community in which the company operates, against the negative effects of integration. Any communication process should be targeted at reinforcing the message that, in the medium/long term, the operation might bring advantages to the external stakeholders, whose reaction is often an important source of feedback on the results achieved through M&As;

c) the transfer of resources and skills from the acquired company to the acquiring company: such a transfer has two functions: creating favourable conditions for creating synergies between the acquiring company and the acquired company; and avoiding the rejection of the new scenario. When such a transfer involves hard resources (such as technologies, patents, equipment, machinery, etc.) that are by their very nature easily transferrable, the difficulties are less serious. On the contrary, soft resources (all immaterial resources, such as distinctive, managerial and organisational skills, etc.) involve more serious difficulties, due to the fact that such resources are intangible and therefore cannot be automatically replicated in a new business context; and

d) more rapid adaptation to new circumstances: in order for the acquired company to achieve good performance in the new context, integration must result in rapid and thorough adaptation. To achieve this purpose, roles and responsibilities should be made clear from the very beginning, so that the conditions for good performance might be created. Furthermore, motivation policies might assist in alleviating integration problems and, therefore, in making the process shorter.

[120] Fubini D., Price C., Zollo M., *Fusioni e acquisizioni*. *Il ruolo della leadership*, cit., p. 15.

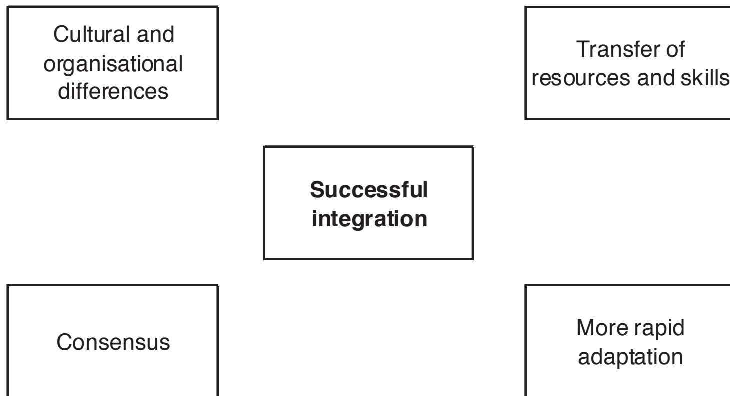

Figure 5.4 Critical factors in the integration process

Source: Personal elaboration

Integration is aimed at achieving various objectives[121]:

a) an increase in company size: integration makes it possible for companies to reach a size that allows for competitiveness;

b) organisational learning: each company involved has the opportunity to acquire new skills and know-how from the others; this process would otherwise be difficult, expensive and/or time-consuming to go through. Organisational learning favours the identification of new development opportunities, which translate into basic research as well as product and process innovation. It also results in an improved use of resources, which in turn increases both the productivity of the means of production and the profitability of capital[122]. Last but not least, organisational learning favours the identification of new practices for strategy development and organisational adaptation[123];

c) economies of scale and of scope: the companies involved might obtain significant economies of scale thanks to various factors: rather uniform production, larger production volumes, and shared resources and know-how (which may even be complementary). On the contrary, when lines of products

[121] Fazzini M., *Aggregazioni, accordi e alleanze tra imprese,* cit., p. 10 ff. Giacosa E., *L'economia della aziende di abbigliamento*, cit., p. 263.

[122] March J.G., "Exploration and exploitation in organizational learning", *Organization Science*, 2, 1991, pp. 71 ff.

[123] Haspeslagh P.C., Jemison D.B., *La gestione delle acquisizioni*, cit., p. 20.

are expanded, companies might obtain economies of scope[124] resulting from reductions in cost thanks to the fact that various products are manufactured within the same system. Such cost reductions resulting from integration are higher than the transaction costs that would be borne when making transactions, i.e. exchanging resources[125]. In spite of the fact that cost reduction is often necessary for the companies involved, the management should develop a broader vision of the integration process; a vision that promotes the creation of a new flourishing company[126] capable of operating in the market in the long term;

d) mitigation of business risk: risk is spread between the companies involved, which is also thanks to product diversification;

e) defence and resistance against competitors: integration might enhance the new company's bargaining power, thereby increasing its competitive advantage. Moreover, competition might be mitigated by involving a competitor in the process of external growth;

f) overcoming obstacles in terms of legislation and government measures: when companies are interested in reaching markets that are heavily regulated and difficult to enter for foreign investors, integration with businesses based in the country might assist them in overcoming such obstacles; and

g) consolidation or development of an international image: when the integration process involves foreign businesses, entering international markets is less complicated, since it is easier for the companies involved to cope with local traditions. This helps in gaining international reach.

5.6.2 Integration Process Stages

There is no one integration approach, since each company involved is unique, as is the context in which they operate. However, regardless of the integration practices adopted, establishing borders between companies is crucial, in that it translates into the possibility of protecting the skills and resources typically associated with each context, while maintaining the opportunity of sharing them. As a result, companies can avoid the coercion that they may

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[124] Di Bernardo B., *Le dimensioni di impresa. Scala, scopo, varietà*, Franco Angeli, Milano, 1991.

[125] Williamson O.E., *L'economia dell'organizzazione: il modello dei costi di transazione*, in Nacamulli R.C.D.,, Rugiadini A., *Organizzazione & Mercato*, Il Mulino, Bologna, 1985.

[126] Coda V., *Prefazione all'edizione italiana*, in Fubini D., Price C., Zollo M., *Fusioni e acquisizioni. Il ruolo della leadership*, cit., p. VII.

otherwise encounter when sudden context changes are resented by the people who work for the businesses involved[127].

Without forgetting that each situation is unique, integration processes might be split into the following stages[128] (Figure 5.5):

a) pre-integration: this stage consists of the creation of the conditions that are necessary to transfer skills and know-how between the acquired company and the acquiring company[129]. It implies thorough knowledge of the initial situation regarding the corporate culture and atmosphere and the distinctive skills and financial resources that are concerned. The strengths of each company involved should be enhanced and any weaknesses should not be underestimated. With a view to acculturation, the management should cope with the conflicts and turbulence inevitably associated with pre-integration, which are due to the fact that the companies involved tend to protect their own values and resources. When particularly serious, such conflicts might cause alienation and rapid staff turnover[130].

Pre-integration requires, on the one hand, information and control systems[131], which should be used to evaluate the initial situation and to transfer

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[127] Cortesi A., *Le acquisizioni di imprese*, cit., p. 192.

[128] Cortesi A., *Le acquisizioni di imprese*, cit., pp. 195 ff. De Noble A.F., Gustafson L.T., Hergert M., "Planning for Post Merger Integration. Eight Lessons for Merger Success", *Long Range Planning*, 21(4), 1988, pp. 82 ff. Appelbaum S.H., Gandell J., Yortis H., Proper S., Jobin F., "Anatomy of a merger: behaviour of organizational factors and processes throughout the preduring-post stages (part 1)". *Management Decision,* 38(9), 2000, pp. 649 ff. Appelbaum S.H., Gandell J., Shapiro B.T., Belisle P., Hoeven E., "Anatomy of a merger: behavior of organizational factors and process throughout the pre- duringpost-stages (part 2)", *Management Decision,* 38(10), 2000, pp. 674 ff.

[129] Pritchett P., Pound R., *High Velocity Culture Change: A Handbook for Managers*, Pritchett & Associates, Dallas, 1996. Tetenbaum T.J., "Beating the odds of merger and acquisition failure: seven key practices that improve the chance for expected integration and synergies", *Organizational Dynamics*, 28(2), 2000, pp. 22 ff.

[130] Worrell D.L., Davidson W.N., Chandy P.R., Garrison S.L., "Management turnover through deaths of key executives: effects on investor wealth", *Academy of Management Journal*, 29(4), 1986, pp. 674 ff. Walsh J.P., "Top Management Turnover Following Mergers and Acquisitions", *Strategic Management Journal*, 9(2), 1988, pp. 173 ff.

[131] McKiernan P., Merali Y. "Integrating Information Systems After a Merger", *Long Range Planning*, 28(4), 1995, pp. 54 ff. Stylianou A.C., Jeffries C.J., Robbins S.S., "Corporate mergers and the problems of IS integration", *Information & Management*, 31(4), 1996, pp. 203 ff. Finnegan P., Murray J. "Between Individuals and Teams: Human Resource Management in the Software Sector", *Journal of Global Information Management*, 7(2), 1999, pp. 4 ff.

resources; on the other hand, it requires efforts to favour attitudes of trust in the people involved in the integration process. While maintaining leadership, the management should emphasise the advantages of integration and persuade the human resources of the benefits they could gain from it, with the purpose of promoting the idea of a new united company from the very beginning. Initially, they should determine the distance that the companies involved should reciprocally keep, in terms of increased or decreased integration and management autonomy. At a later stage, the mission of the companies involved should be defined and this might or might not be different from the pre-merger mission. Mission definition translates into a global view of company objectives, i.e. an overall view of the new company as a coherent whole.

In order to evaluate integration performances, the management of the acquiring company should implement evaluation and control policies that might assist with any redefinition of company objectives. Often, the acquired company needs restructuring[132] (in terms of organisation, finance and manufacturing systems) before the integration process gets under way;

b) integration management: this stage focuses on translating the advantages resulting from acquisitions into economies of scale and of scope, when strategic skills are transferred and resources shared. Integration should not be managed in haste, since this might prevent the company from focusing on a partner's specificities and thereby missing opportunities and increasing the risk of integration failure. Furthermore, every single aspect of integration management favours organisational learning, which in turn assists each company involved in aligning with its partners[133]; and

c) post-integration: this stage is focused on translating the advantages typically associated with business combinations into an increased competitive advantage. The performances obtained in this stage might be usefully protected through various mechanisms.

[132] Bowman E.H., Singh H., "Corporate Restructuring: Reconfiguring the Firm", *Strategic Management* Journal, 14(S1), 1993, pp. 5 ff.

[133] Fubini D., Price C., Zollo M., *Fusioni e acquisizioni*. *Il ruolo della leadership*, cit., p. 118.

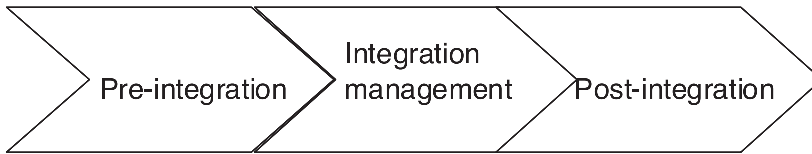

Figure 5.5 Stages in the integration process

Source: Personal elaboration

The literature has identified the main sources of integration problems. According to some scholars, size can play a key role[134]: as corporate size increases, managing a company might become more difficult and the integration process might become longer and more complicated. Other scholars[135] have observed that integration problems are due to cultural differences, which make thorough integration more difficult to achieve without changing fossilised differences, habits and behaviours. Moreover, the time it takes for the integration process to be completed is related to the level of integration to be reached: when this level is low (for instance, when a manufacturing company is acquired by a financial holding company or when acquisitions are performed with a view to diversify), the integration process is usually short. On the contrary, problems are more serious when a considerable level of integration needs to be reached, typically in cases of horizontal acquisitions: the integration process becomes lengthier and integration costs become higher.

Integration problems depend also to the various types of integration in which the companies are involved:

a) horizontal integration; and
b) vertical integration.

[134] Kitching J., "Why Do Merger Miscarry?", cit., pp. 84-101.

[135] Nahavandi A., Malekzadeh A.R., "Acculturation in Mergers and Acquisition", *Academy management Review*, 13, 1988, pp. 79 ff. Chatterjee S., Lubatkin M.H., Schweiger D.M., Weber Y., "Cultural Differences and Shareholder Value in Related Mergers: Linking Equity and Human Capital", *Strategic Management Journal*, 13(5), 1992, pp. 319 ff.

5.5.3 Horizontal Integration

Horizontal integration results from strategies of external growth aimed at strengthening the role that companies hold in their sector and in their line of business[136]. Such a goal is reached by focusing on existing products; new markets might be reached or existing markets might be tackled more aggressively.

Alternatively, the company offer might be expanded through differentiated products, i.e. through various lines of products with similar technologies to be sold on the same market. Last but not least, companies might further develop the potential functions of their products, in order to improve customer satisfaction (Figure 5.6).

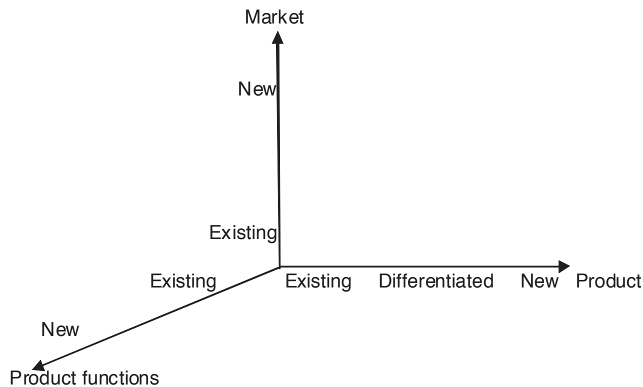

Figure 5.6 Possible moves of horizontal integration

Source: Personal elaboration

Integration is not only aimed at increasing sales; in fact, it is also directed at reaching a more sound competitive position[137] within the sector and the business in which the companies operate[138].

Integration often involves competitors operating in the same sector[139]: for instance, a company manufacturing watches might decide to acquire another company that manufactures watches targeted at the same segment or at different

[136] Giacosa E., *L'economia delle aziende di abbigliamento*, cit., pp. 266 ff.

[137] Giaccari F., *Le aggregazioni aziendali,* cit., p. 37.

[138] Potito L., *Le operazioni straordinarie nell'economia delle imprese,* cit., p. 7.

[139] Pellicelli G., *Strategie di impresa*, Egea, Milano, 2010, p. 347 ff. Melis G., *Elementi di Economia Aziendale,* cit., p. 57.

ones. Both companies seek growth within their sector and aim at increasing the size of their manufacturing or commercial units.

The benefits deriving from horizontal integration might be evaluated on the basis of the improvements achieved by the companies involved in terms of competitive advantage[140]:

a) greater market reach: gained thanks to the position that each company held in the market before merging. The companies involved might gain greater market share in the segments in which they operate or in new ones;

b) wider lines of products: the synergies created with other companies translate into wider lines of products being offered, both in the segments in which the companies involved operate and in new segments. When LVMH acquired Bulgari, they not only doubled the turnover of their jewellery and watches division but also gained greater market reach in Europe, Asia and the United States;

c) increased resources and know-how: synergies also allow for organisational learning. The skills contributed by the companies involved in the integration process are often highly specialised and would be difficult and/or expensive to develop. In addition, resources that are scarce might be made available;

d) lower unit costs of production: integration allows for some of the activities individually performed by the companies involved to be united (particularly sourcing and logistics activities), which translates into lower unit costs of production; and

e) increased bargaining power: for all the previous reasons, the companies involved become more competitive, thereby successfully preventing new competitors from entering the market.

5.5.4 Vertical Integration

Vertical integration is aimed at increasing control at an earlier and/or later stage of the supply chain in which the company operates[141]. On the basis of the

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[140] Giacosa E., *L'economia delle aziende di abbigliamento*, cit., pp. 267.

[141] Bastia P., *Principi di economia aziendale*, Cedam, Padova, 2009, p. 253. Giaccari F., *Le aggregazioni aziendali,* cit., p. 38. Melis G., *Elementi di Economia Aziendale,* cit., p. 57. Hurrigan K., *Strategy for Vertical Integration*, Lexington Books, 1985. Perry M., *Vertical Integration: Determinants and Effects*, in Schmalensee R., Willig R.D. (eds.), *Handbook of Industrial Organization*, vol. I, North Holland, New York, 1989. Davis R., Duhaime I., "Diversification, vertical integration, and industry analysis: new perspectives an

phase in which the integration takes place, the following types might be defined[142] (Figure 5.7):

a) upward integration: this involves the phases that are closer to the suppliers. Target markets are not modified, since integration efforts are concentrated on the manufacturing stage. This might assist in reducing sourcing-related costs, which are replaced with more easily monitored costs of production. Likewise, when resources are scarce, vertical integration increases the availability of such resources in terms of when and how they are needed. Vertical integration takes place, for instance, when an apparel manufacturing company acquires one of its fabric suppliers. Companies such as Armani and Valentino have opted for vertical integration and purchased various manufacturing companies, some of which used to work for them as subcontractors;
b) downward integration: this involves the phases that are closer to the customers and focuses on products. This process might be aimed at integrating one or more external retailing partners (in the case of indirect sales) or at establishing a direct relationship between the company and the final customer through a sales network (in the case of direct sales). Luxottica, for instance, has purchased over 470 stores in Chile, Peru, Ecuador and Colombia. Target markets might be modified, since companies may decide to focus on distributing and marketing their products. When integration involves retailing partners, it results in more flexible management of stock and, ultimately, in decreased retailing costs; companies also get part of the mark-ups created in the marketing phase.

Vertical integration might also involve partners located in more than one phase of the supply chain, i.e. closer to suppliers and closer to customers.

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[142] Giaccari F., *Le aggregazioni aziendali*, cit., p. 39.

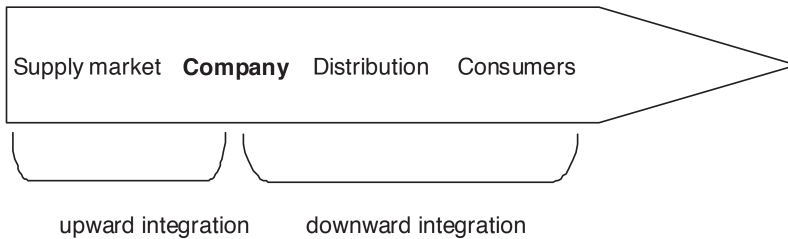

Figure 5.7 Vertical integration

Source: Personal elaboration

It follows that, thanks to upward and/or downward vertical integration, companies can increase their competitive advantage as a result of the increase in size; this makes it more difficult for new competitors to enter the market, since they have to cope with the higher bargaining power achieved by the company. When the added value associated with the various activities internalised is integrated, the added value created by the company (as a whole) increases.

Vertical integration is typically associated with the following advantages[143]:

a) increased added value: added value, i.e. the difference between revenues and external costs, might increase, thanks to the integration of the added value associated with each activity internalised;

b) improved sourcing activities: control of manufacturing companies translates into control of sourcing activities, which results in more efficient and timely supplies of the means of production. In the case of upward integration, such control also allows for reductions in production costs;

c) improved product quality: when focusing on the manufacturing phase, companies achieve an increase in product quality. For instance, a luxury car manufacturing company might decide to integrate a small leather tanning firm, in order to get full control of the quality of the leather used to manufacture its car seats. Product quality is also enhanced thanks to the skills and know-how contributed by the companies involved: this improves the level of innovation, which in turn enhances quality;

d) more effective barriers to entry for competitors: closer control of the supply chain, or even full control of the supply of very scarce resources, makes it difficult for competitors to enter the market. Moreover, companies

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[143] Giacosa E., *L'economia delle aziende di abbigliamento*, cit., pp. 265 ff.

that purchase suppliers might later decide to increase prices, thereby making it difficult for competitors to get certain means of production. In the case of downward integration, restocking in favour of competitors might cause prices to increase when a certain means of production is not easily available from other sources; and

e) improved planning and control in manufacturing processes: vertical integration enhances the planning and control of the manufacturing phases controlled by the company. This provides more opportunities to promptly cope with changeable market conditions.

However, vertical integration also involves various disadvantages, such as:

a) increased production costs: vertical integration does not always translate into reductions in production costs. In the case of upward integration, external suppliers might be more competitive than the integrated ones, thus causing sourcing costs to increase. Furthermore, the rapid obsolescence characterising technologies might increase the obsolescence risks for the company's own systems. Such risks are considerably increased when integration involves more than one phase of the supply chain. Nevertheless, companies opt for vertical integration, or often for partial vertical integration, in order to improve their image, i.e. to show that their products are internally manufactured;

b) reduced flexibility: when the new company reaches a considerable size, it might be flooded with bureaucracy and become rigid in management procedures. This causes organisational costs to increase;

c) difficulties in de-integration processes: because of major barriers to exit, companies might have to cope with serious difficulties in order to give up integration. Typically, it may be impossible to dismiss staff;

d) problems in dealing with demand: when demand is fluctuating, companies might find it difficult and time consuming to coordinate the various activities along the supply chain. On the contrary, external sourcing requires more flexible management and less planning; and

e) reduced market demand: reductions in the demand affect the whole supply chain, since they have an impact on satellite industries. Therefore, thoroughly vertically integrated groups are greatly affected by declines in consumption, which impact on the various phases integrated into the group. For instance, a reduction in the demand for jewellery affects both the business of shops and the business of the manufacturing and retailing companies that are integrated with those same shops.

In order to mitigate the advantages and disadvantages resulting from verti-

cal or horizontal integration, companies might opt for a combined form of integration, i.e. partial integration. From the point of view of manufacturing processes, some of the activities are carried out internally, while others are outsourced (for example through subcontracting). From the point of view of retailing, companies might use their own sales networks or resort to external retailing companies.

Partial integration is efficient in terms of manufacturing flexibility, since it does not require a complex manufacturing structure while allowing for large quantities to be obtained: the demand that cannot be satisfied by the company might be satisfied by external players. Furthermore, partial integration translates into increased competition between the supply market and the companies integrated, thereby enhancing product quality and avoiding problems related to delays. However, partial integration does not allow for significant economies of scale, since some manufacturing processes are outsourced. Finally, combining the processes outsourced and those carried out internally during the manufacturing and retailing phases requires considerable coordination efforts[144].

[144] Giacosa E., *L'economia delle aziende di abbigliamento*, cit., p. 268.

Conclusions

To exploit the potential of the luxury market, companies have to combine with others, in a more or less formal way. As a result, businesses can cooperate, share resources and acquire knowledge, in order to reach a common goal. Typifying business combination is a rather difficult task, since various criteria and types of combination might be used, even more so if informal deals are included. One of the distinguishing criteria might be the intensity of integration: in this sense, business combination can be total (involving all management aspects) or partial. This affects the autonomy of the companies involved, which might be severely limited (especially in the first case).

Strategic alliances are a sort of formal business combinations. Strategic alliances enable companies to assess both the partner's skills and the effects of any subsequent purchase: entrepreneurial risk is reduced and performances are improved. Such circumstances are favoured by the awareness that strategic alliances are reversible, unlike acquisitions, which are not easily reversible. Alliances with partners often lead to acquisitions.

Strategic alliances are not aimed at simply trading goods or services. In fact, they encompass various aspects of the companies management involved (manufacturing, sales and R&D), with the purpose of gaining a competitive advantage for each company. The companies involved aim at expanding their chain values by sharing certain activities and cooperating among themselves. Production performances improve due to the use of skills and knowledge of the partners.

In addition, such strategic alliances enable the companies to overcome limitations related to size: when a company's size does not allow for a certain activity to be carried out or for new conditions of market demand to be dealt with, cooperating with others provides new opportunities to reach such goals. Also, limited financial resources might drive a company to seek an alliance: by uniting financial resources, new competitive challenges might be met. The risk of holding a reduced market share is mitigated thanks to the higher business flexibility resulting from the alliance; the synergies created among the companies involved make it possible for them to respond to sudden changes in demand in a more rapid way.

A joint venture is an instance of a strategic alliance. With joint ventures and, more generally, with strategic alliances, the partners might obtain considerable economies of scale. Some activities are carried out for the benefit of all the companies involved,

allowing for lower costs. Furthermore, increased volumes reduce manufacturing costs and mitigate risks for the companies involved. Last but not least, each company involved can benefit from the know-how and skills of the others, without having to acquire their own know-how and skills. This provides new opportunities for increasing their competitive advantage, either by reaching a new market or by developing a highly innovative line of products. This is possible when the integration among the parties is properly managed and any conflict between the companies over the joint use of resources and skills is resolved.

In 2011, the number of worldwide M&As in fashion and in the luxury context decreased by 33% versus 2010, due to the global crisis. Nevertheless, the quality of M&As has increased through the acquisition of historic and promising brand by large international luxury groups.

Foreign investors have shown remarkable interest in Made in Italy: 16% of the M&As performed in 2011 were targeted at Italian companies by foreign ones. Therefore, Made in Italy is worldwide recognized for its excellent quality of their products and the historic world-class brands.

In M&As, the brand strategy is a key element of acquiring company strategy. The brand represents an intangible asset and brand extensions are often performed.

"Merger mania" in the luxury business has been characterised by several objectives. From the perspective of the acquiring company, M&As might permit an increase in size, an expansion of business scope from a geographical point of view, an acquisition of an appealing well-established brand, a brand extension to several merchandise categories, a creation of synergies and a control of the supply chain.

Also for the acquired company, M&As have a positive influence in terms of manufacturing, sales, organisation and performance. By combining the acquiring company's skills, know-how and financial resources, the acquired company latter might improve the manufacturing process and expand its scope.

M&As might produce several synergies in the management of the involved companies:

- commercial synergies: they are aimed at expanding the new company's market reach as opposed to the external players that orbit around the supply chain, with the purpose of increasing its bargaining power at both the sourcing and retailing stages. Moreover, an improved line of products (both in terms of quality and innovation) enables the company to differentiate its offer from those of its competitors; and
- synergies in sharing resources: by exploiting the material resources of the acquired company, the acquiring company can expand its production capacity without making its structure more rigid. In addition, the joint use of immaterial resources allows for more innovative lines of products, which lead to higher competitive edge. Last but not least, economies of scale and of scope might be obtained.

The integration process is crucial to the success of any such operation of M&As in the luxury business. This management stage may vary depending on the kind of integration being carried out:

- integration through absorption: this is characterised by considerable strategic

interdependence between the companies involved and, consequently, by limited organisational autonomy. Therefore, company borders can be crossed and the integration process accelerated. In order to do so, a detailed integration plan should be formulated and an integration leader identified. Various management boards might also be created to take care of the most critical functions;

- integration through conservation: this is characterised by considerable organisational autonomy at the expense of company interdependence. The borders existing between the businesses involved should be maintained. In order to do so, the role of a guarantor or a board of guarantors is created, with the purpose of protecting the functionality and independence of the acquired company. This role is maintained at least until the disruption risks are mitigated; and
- integration through symbiosis: this is characterised by a combination of strategic interdependence and organisational autonomy. All exchanges of resources and know-how between the businesses involved should be performed in respect of company borders. In order to tackle the various problems resulting from integration, a board of managers might be appointed (including managers from the acquired company) and entrusted with the management of the relationship between the businesses involved. This stage is rather complex because it requires human resources to be carefully managed and constantly motivated; the most efficient individuals must be kept in the company.

Every delayed or wrong move in the integration process might have devastating consequences on all aspects of company management and influence negatively the M&As performances.

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