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1.) EXECUTIVE SUMMARY

This research report is based on the recently accelerated trend of upward vertical integration among luxury brands. Facing the decline of physiological raw materials and the shrinking amount of artisanal skills, luxury leaders in fashion, cosmetics, and jewellery are now competing for the procurement of these resources. The goal of this report is to find out the reasons behind this trend, by looking into what type of luxury brands are investing and which segments they are investing in, as well as looking into the motives given by brands and industry experts for the recent acquisitions of their suppliers, thereby leading to possible reasons why luxury companies are integrating their supply chains. The rationale and relevance for investigation comes from the fact that over recent years we have seen brands like Chanel set up a subsidiary company to incorporate satellite ateliers, and big luxury companies like Hermès and LVMH purchasing shares in tanneries world wide. It was also stated in the M&A Blackbook report by Bernstein Research that vertical integration is one of the key reasons for mergers and acquisitions within the luxury sector.

In order to explore the main sectors of investment, and the advantages of securing certain resources, an investigation by means of literature research and corporate interviews took place. Firstly, the active luxury companies in the segment were analysed, with Chanel, LVMH, Hermès, Kering and Bulgari coming to fruition as some of the main brands who have been investing in their supply chains. After studying the various deals that took place between luxury brands and their suppliers, it was possible to conclude the main areas of investment. Firstly, brands tend to frequently invest in artisanal companies with traditional know-how. Secondly, the leather and exotic skins segment has been a major consolidation focus of luxury companies. A third area of investment has been in the supply of cosmetics and perfume ingredients, with brands like Chanel and Dior buying land to cultivate production jasmine and roses as a way to ensure continuity of their products. Lastly, the jewellery and watch industry is another big investment sector, with brands investing in everything from reviving traditional techniques to diamond minds in Southern Africa.

After the major areas of consolidation had been determined, the motives given by each of the brands for these deals were explored and summarized. The main reasons determined at this point for why brands are vertically integrating their supply chains are: the need to serve a growing demand, to guarantee and maintain the best quality, to preserve know-how, to have control over the whole process of product development and distribution, to have control of costs, logistics, and inventory, brand prestige, and to aid efficiency and flexibility. However, considering the fact that brand representatives will always answer with a response that reflects positively on the brand, we can not take these reasons as the absolute truth, and therefore it is necessary to investigate additional benefits that may come from the vertical integration of the supply chain by a luxury brand.
Considering the findings of which companies are making investments, which areas they are investing in, and what their reasons are for these investments, and combining these findings with theory that explains the benefits of supply chain management, and the opinions of industry experts, it was possible to determine the main possible benefit incentives for luxury brands to integrate their supply chains. The main benefits that were established were placed into the categories of: product provenance, control of quality and supply, prevention of counterfeit goods, pricing and cost reduction, craftsmanship and heritage, competitive advantage, and economies of scale. Each category makes use of various examples and theories to explain why vertical integration would be beneficial to a luxury brand and can there be considered as viable reasons for why luxury companies are choosing to vertically integrate parts of their supply chain.
SELECTION 1
1.1) INTRODUCTION

My research report is an examination into how and why luxury brands are vertically integrating their suppliers of luxury goods and raw materials. Presently, the highly-skilled handcraft artisans and valuable raw materials on which luxury companies depend are on the decline, which can result in possible hidden costs and potentially long-term consequences for these companies. In recent years, various, progressive luxury companies have been acquiring essential elements of their supply chains as a way of ensuring the survival of their production resources. Having control over the entire supply chain is now regarded as a key element to success. My thesis will analyse the causes and consequences of the movement of luxury brands towards vertical integration. The aim of this research proposal is to explore the phenomenon of vertical integration in the luxury segment in order to determine the reason behind the trend. The report will begin by explaining the rationale behind the chosen topic – what the reasoning is to explore this issue and what the broader relevance is. Furthermore, it will create an understanding of the terms luxury, vertical integration, and supply chain, in order to establish a clear base of reference for the rest of the report. It will then go on to explore the types of brands that are making these investments, and the segments they are investing in. Thereafter, the reasons that the brands give are considered, and then used and combined with theories pertaining to the benefits of vertical integration in order to determine a set of concrete and viable reasons for why a luxury brand may decide to vertically integrate.

1.2) RATIONALE & RELEVANCE

Over the last few decades, and more noticeably in the past three to four years, there has been a trend amongst some of the world’s biggest luxury brands to acquire the suppliers of their luxury materials. I thought it would be interesting to find out the extent to which supply change strategies influence the success of the luxury industry. In recent years, we have seen major luxury brands competing for highly desirable retail space in emerging markets, but now that they have established store-fronts and presence in countries with high growth potential, they have switched their strategic direction. Facing the decline of physiological raw materials and the dwindling amount of artisanal companies, luxury leaders in fashion, cosmetics, and jewellery are now competing for the procurement of these valuable assets.

In the M&A Blackbook by Bernstein Research (Ortelli and Patel, 2014), they list three key reasons for mergers & acquisitions in the luxury sector: brand portfolio extension of luxury groups, vertical integration, both upward and downward, and financial investment. It was noted that in the Luxury M&A Deal Flow: Brand Portfolio Extension and Financial Investments were the main drivers, but vertical Integration was also picking up, and merger and acquisition deals in the next three years are expected to be mainly focused on brand portfolio extension and vertical integration. In 2013, brand portfolio extension took place with luxury companies such as LVMH and Loro Piana, Kering
and Pomellato, and Swatch and Harry Winston; and the vertical integration deals that took place included: Swatch and Rivoli (distributor in the Middle East), Hermès and Chanel buying tanneries, and Hermès buying Joseph Erard, a watch case producer. Vertical integration both upward and downward, though small in value terms, are significant in numbers, as luxury companies look to secure the supply of raw materials (in case of upward integration) and to gain stronger control of their retail operations, and inventory (in case of downward integration). The deal flow has been consistent over the years and it is believed that it will remain consistent with past trends in the coming years with more and more luxury goods players looking to internalize retail operations and secure their supplies (Ortelli and Patel, 2014). There are various examples of downward integration, such as Swatch investing in its Middle Eastern and Chinese distributors, Rivoli and Hengdeli respectively, and Richemont buying online watch retailers Net-A-Porter and Shouke. However, more interestingly, upward integration is particularly on the rise as a means of securing strategic supplies like exotic skins and components for watches (Ortelli and Patel, 2014). For example, in 2013, Kering bought France Croco to secure the supplies of crocodile skins, and Hermès bought crocodile farms in Cairns (Australia) and Louisiana (USA), and LVMH also bought a majority stake in Heng Long, a crocodile farm in Singapore in 2011. Therefore we see that this trend toward upward vertical integration, while not as dominant as brand portfolio extension or financial investments, is clearly on the rise. One of the most prominent examples of this is Chanel, which between 1997 and 2006, procured six highly specialised French ateliers that included Embroidery firm Lesage, costume jewellery and button-maker Desrues, floral fabric artisans Guillet, feather-maker Maison Lemarié, gold and silversmiths Robert Goossens and boot-makers Massaro (Reedy, 2009). In the 1920s there were about 10,000 couture-level embroiderers in France; today that number has shrunk to around 200, and the decreasing demand for these ateliers’ services has resulted in the Wertheimer family and designer Karl Lagerfeld coming up with a strategy to keep them in operation, by incorporating a subsidiary to manage these satellite ateliers called PARAFFECTION, with the purpose of nourishing the craft that is the quintessence of Paris couture (Reedy, 2009). The ateliers operate entirely independently, also supplying competitors, and while Chanel stands to benefit from financial self-interest, haute-couture could not continue at the same level without these skills, and Chanel insists that its primary motive goes beyond turning a profit. Senior press officer for theMaisons d’Arts, Nathalie Vibert (Reedy, 2009) claims that these acquisitions:

“amount to a genuine wager on creativity, which, beyond preserving unique archives and know-how, allows such craftsmanship to grow and bloom in full independence. The aim is clear: it is not for Chanel to grab exclusive suppliers, but to nourish a craft which is the quintessence of Paris couture. Nor is it to save the last remnants of disappearing tradition. To the contrary, all highly profitable at the time of their purchase, these firms can now look at the future with hope and serenity.”
Not only has Chanel been securing their supply chain in regards to skilled labor and know-how, but they have also been locking down their raw materials. The company recently purchased land near Grasse, dedicated to the cultivation of jasmine and roses for its No. 5 perfume. Furthermore, they re-introduced Florentine Iris to the area, as it yields a rare and expensive extract after several years used for its No. 19 perfume. In New Caledonia, they have also set up partnerships with sandalwood growers (Wendlandt, 2013). In addition, Chanel also acquired their long-time lamb hide provider, Bodin-Joyeaux. It is the first tannery they have acquired, and is the provider of the supple, silky lamb leather used to make Chanel’s popular quilt leather bags. Regarding this acquisition, Bruno Pavlovsky stated that they wanted to preserve the know-how of Bodin-Joyeux, who are lambskin specialists. He also explained that they will continue to supply rivals, as do other Chanel suppliers. Furthermore, he clarified that the average price of leather is rising because people are eating less red meat, and he estimated that the price of both lamb and calf skin has risen by 20-30% in the last 3-5 years (Wendlandt and Denis, 2013). These are just some of the examples, of some of the areas, that one luxury brand has been integrating into. But the trend is much wider, stretching all across the luxury industry, from cosmetics to jewellery. And more brands, including LVMH, Hermès, Kering, and Bulgari and their acquisitions will be explored.

1.3) AIM

After exploring which luxury brands are vertically integrating in which sectors, one of the main focus areas will be the reasons that luxury brands give for their vertical integration in specific areas. For example, their reasoning is sometimes to ensure their quality and supply, so if that is their goal, then why do they only invest in certain suppliers and not others? The answers from brands themselves in press releases and media statements will be examined, determining common motives among brands for the various sectors. Thereafter, the possible additional benefits that come from consolidation will be explored. Looking at both the reasons given by the brands, as well as additional benefits that may not have been stated by the brands themselves, it will be possible to come to a more clear understanding of why this trend has been occurring so prominently over recent years.

My goal is to explore the reasoning behind it by looking into the main sectors of investment, both raw materials and skilled labor, and exploring the advantages of securing these resources. The benefits that could come from vertical integration will be investigated, in areas such as: the assurance of supply and quality, the assurance of ethical and sustainable practices, prevention of counterfeit goods, competitive advantage and creation of barriers to entry, the potential to keep skills and resources alive, cost reduction and profitable self-interest. Thereby, to understand to what extent the choices of supply chain strategy influence the success of these companies.
Overall, my thesis will result in a thorough examination into the reasons for this trend towards vertical integration among luxury brands by looking into historic investment segments and the possible reasons given by brands and industry experts for these investments.

There are numerous questions that need to be answered in order to gain a clear understanding of the movement towards vertical integration. Firstly, it should be made clear what we mean when we talk about luxury brands and vertical integration of their supply chains. What is considered a luxury brand in this report? What are supply chains, and what is vertical integration? Thereafter, we need to look at which luxury companies have been investing in their supply of raw materials and expertise. Which luxury companies are making investments? Which sectors have they been investing in? Once the main segments of investment have been determined, we need to look at the reasons that luxury brands are giving for vertical integration. What reasons are they giving for specific investments, and are the reasons similar among different brands? Subsequently, what could the additional benefits of investing in their supply chains be? How does vertical integration reflect on their brand profile, and does having control over their supply chains influence their success?

1.4) RESEARCH METHODOLOGY

Given the research objectives, different research methodologies were used to pursue the various answers. Firstly, it should be mentioned that due to the culture of secrecy within the fashion industry, and specifically the luxury sector, the ability to source data is more complicated. Therefore the main methods of research were:

- International literature was analysed and constantly monitored, especially in regards to the examined companies (company background, size and structure, annual reports and financial information, case studies, press, social media) and in relation to the resources and skilled labor within the luxury industry. Furthermore, the concept of vertical integration was examined using theoretical and historical literature.
- Interviews were conducted as a means to explore the themes through the eyes of industry experts, including Mario Ortelli, a senior research analyst at Sanford C. Bernstein, Franck Delpal, an economics teacher at IFM whose PhD thesis was written on the subject of vertical integration among luxury brands, and Henny Jordaan, a supply chain expert at AMFI.
1.5) LIMITATIONS

Firstly, in regard to literature research, most supply chain models are developed for mass market consumer goods companies, and therefore, literature relating to the luxury goods industry is mainly focused on sociological, marketing and branding aspects, and not on the field of supply chain management. I relied mainly on media articles and press releases from the luxury brands in order to source information on the consolidation deals between brands and their supply companies, but as it is impossible to find every article written about every brands' acquisitions in their supply chains, there may have been information that I did not discover. Furthermore, luxury brands like to maintain an air of mystery as a part of brand appeal, and are therefore very tight-lipped about their ownerships and acquisitions, and are not very accessible to the public, and therefore I was not able to get into contact with any representatives from the actual companies being analysed which lead me to instead seek information from industry experts in the luxury sector and field of supply chain management. Had I received a response from any of the actual companies being observed, the results may have been very different. Additionally, if I had chosen to speak with alternative industry experts their answers would most likely be different as well. Lastly, it should be noted that the positive stance taken towards to rising trend of upward vertical integration by luxury brands can be affected by macroeconomic and sector-specific risks; companies’ consolidation decisions depend highly on their profit earnings which may be influenced by various turbulence in the market, and investment areas may also be influenced by country specific instabilities.

1.6) STRUCTURE

The structure of the report has been established to create a straightforward flow between the topics and facilitate a level of ease when reading the report. The report will begin by explaining the definitions and description of the phenomena used in the report, specifically luxury brands, vertical integration and supply chains. Thereafter, the report moves on to an overview of the prominent brands that have been making acquisitions in relation to their supply chain. This overview leads to an analysis of the main segments that are being invested in, which are outlined as: skilled labor and artisans, leather and exotic skins, cosmetics and perfume suppliers, and jewellery and watches. The analysis moves on to explore the reasons given from brands about why they went forward with their acquisition deals, and what the motives were for the various deals. The report then shifts focus toward what all of the possible benefits could be for a luxury brand that vertically integrates its supply chain. Thereafter, future areas of investment are explored, leading to a final conclusion summarising the main findings and deductions.
1.7) DESCRIPTION OF PHENOMENA
1.7.1) LUXURY BRANDS

The definition of luxury can have various meanings according to who is asked, and is therefore a relative term that depends on perspective (Heine, n.d.). The relativity of luxury splits into a regional, temporal, economic, cultural and situational relativity. Depending on the perspective, luxury is associated with various values and characteristics like exclusivity and privilege, status and prestige, self-reward and reassurance, quality and long-lasting performance, and heritage and innovation. The definition of a luxury brand may be summarized as follows, ‘Luxury brands are regarded as images in the minds of consumers that comprise associations about a high level of price, quality, aesthetics, rarity, extraordinarity and a high degree of non-functional associations,’ (Heine, n.d.).

Positioning in the luxury market has a very strong basis from brand image; emotional factors are of high importance and customers want reliable, high quality, perfect products as well as a story and emotional involvement. Antoni et al. (2004) propose that the success of a luxury brand is due to three main aspects: excellence, brand aura, and desirability.

Excellence: in the customer’s mind, the most formidable association with luxury is excellent quality of both the product and service. Every luxury goods company needs to offer excellence on all levels, as this justifies the premiums paid by their customers.

Brand Aura: by achieving excellence, luxury companies gain a strong reputation and positioning in the luxury market. A legitimate and identifiable brand aura is paramount to achieving luxury status.

Desirability: luxury brands need to create and maintain desirability, which they do by: creating aesthetic appeal that is modern but related to traditional values, high pricing that strengthens the social symbolism of the product, and emphasizing the scarcity and uniqueness of the product.

The most powerful luxury brands, and those with the most buying power, are those with a long-lasting history which tend to be more exclusive and benefit from a stronger brand positioning and resilience versus younger brands. Typically they are the first choice of the consumers, and they have superior pricing power, therefore out performing more recently established brands (Ortelli and Patel, 2014). Brands with a strong heritage are often the most elitist like Hermès and Chanel, and therefore are expected to grow faster and enjoy higher margins. Considering the typical classification of luxury brands based on perceived exclusivity and pricing, Ortelli and Patel (2014) came up with a way for brands to be identified using three clusters:
- Elitist: Luxury brands at the top of the exclusivity pyramid with uniqueness, iconic status, and long heritage as the key characteristics and top notch pricing. E.g., Hermès, Bottega Veneta, and Breguet.
- Aspirational: Luxury brands with distinctiveness and recognition as key characteristics along with very high pricing. E.g., Louis Vuitton, Prada, and Cartier.
- Accessible: Luxury brands with affordable pricing and less exclusivity. E.g., Burberry, Coach, and Baume & Mercier.

Research analysts Ortelli and Patel (2014) noted that they expect “elitist” brands such as Hermès, Chanel, and Bottega Veneta to achieve better growth rates than „aspirational“ brands like Louis Vuitton and Gucci, and „accessible“ luxury brands such as Burberry, Coach, and Mulberry due to the trend of constant trading up and sophistication of luxury consumers. They noted that the Chinese are the biggest consumers of luxury goods and also favour heritage and long history. Behind the US, Greater China is the second biggest luxury market worldwide, and it is the fastest growing market, representing 25% of the global luxury spend (Ortelli and Patel, 2014). That clientele is thus essential and need to be attracted by featuring products with the right characteristics of luxury products which can be summed up as: high quality craftsmanship related to brand expertise, good brand reputation, heritage, rarity, and expensive price (Heine, n.d.). Therefore, only brands in the elitist and aspirational categories will be focused on in this research report as they have the highest expected growth and therefore the most spending power and cash to put towards investing in upward vertical integration. Furthermore, only industrial luxury goods produced by internationally known brand names will be taken into account, therefore excluding antiques, collection items, artworks, services, and real estate.

1.7.2) VERTICAL INTEGRATION

Vertical integration can be explained as the merging together of two businesses that are at different stages of production, for example a shoe manufacturer with a retailer. Whereas horizontal integration would involve two businesses at the same stage merging together, for example two retailers (The Economist, 2009). Investopedia (2009) defines vertical integration as when a company expands its business into areas that are at different points on the same production path, such as when a manufacturer owns its supplier and/or distributor. It is further stated that vertical integration can help companies reduce costs and improve efficiency by decreasing transportation expenses and reducing turnaround time, among other advantages, however, sometimes it is more effective for a company to rely on the expertise and economies of scale of other vendors rather than be vertically integrated. Nonetheless, vertical integration can help companies: gain an increase in market power, with costs savings or efficiency gains, with reduction of uncertainty, as a means of differentiation, and to create a competitive advantage. This research report is
mainly focused on the trend of upward vertical integration, which is when an organization acquires the input suppliers and is in direct control of how the products are supplied to its businesses. In other words, it is when a company vertically integrates their supply chain, from raw materials to manufacturers.

1.7.3) SUPPLY CHAIN

The trend I have focused on is highly linked to the vertical integration of luxury brands in regard to their supply chain, both of raw materials and of craftsmanship. The supply chain is defined in Oxford Dictionary as ‘the sequence of processes involved in the production and distribution of a commodity.’ There are two main supply chain models which exhibit the benefits of supply chain control, the first is the Lean vs Agile model. In a lean supply chain the focus is on efficiency, pursued through eliminating waste and activity streamlining, as well as reducing costs. Whereas in an agile supply chain the focus is on effectiveness, meaning speed, flexibility and responsiveness (Moayed and Shell, 2009). This can be linked to the Functional Vs Innovative Products model (Fisher, 1997), where functional products match with efficient supply chain management, and innovative products match with a market-responsive strategy.

However, luxury products don’t really fall under either category. They are not considered functional because cost issues are not as relevant, and they are not considered innovative because the stress is not on reactivity performance or innovation is not related to supply chain, and some products are valued for being ‘classics’. Therefore, luxury products should be classified as unique products (Lamming et al., 2000), with their uniqueness brought about due to brand reputation. Uniqueness should be created, supported and maintained by managing in an appropriate way the various steps of the supply chain (Bowman, 2004).

Most supply chain models are developed for mass market consumer goods companies, and therefore, literature relating to the luxury goods industry is mainly focused on sociological, marketing and branding aspects, and not on the field of supply chain management. While this may create some difficulties when searching for answers, it makes it more interesting to explore.
SECTION 2
2.1) THE TREND UNCOVERED

Now that the terminology of what is considered to be luxury, what is vertical integration and what a supply chain is is understood, we can begin to explore the trend. To understand the trend towards vertical integration in the luxury segment it is necessary to understand the type of luxury companies that are making acquisitions and the areas that they are investing in. By looking into recent articles it can be seen that the main luxury brands and luxury conglomerates that are investing in this segment are: Chanel, LVMH, Hermes, Kering, and Bulgari. These companies fall into the elitist and aspirational clusters. Meaning they are very exclusive, iconic, recognisable, expensive and have a long history. If focus is shifted toward the types of investments being made, it can be seen that investments are being made into both hard and soft luxury. Hard luxury is generally known as jewellery and watches, whilst soft luxury is more fashion driven like ready-to-wear and couture. Each brand and their investments will be explored.

2.1.1) CHANEL

Chanel S.A. is a high end fashion house that specializes in haute couture and ready to wear, luxury goods and accessories, it is a privately held company owned by the Wertheimer family. Chanel is one of the most prominent examples of the trend of luxury brands expanding through upward vertical integration, as between 1997 and 2006, the company procured six highly specialised French ateliers which included Embroidery firm Lesage, costume jewellery and button-maker Desrues, floral fabric artisans Guillet, feather-maker Maison Lemarié, gold and silversmiths Robert Goossens and boot-makers Massaro (Reedy, 2009). The Wertheimer family and designer Karl Lagerfeld came up with a strategy to keep ateliers with diminishing demand in operation, by incorporating a subsidiary to manage these satellite ateliers called PARAFFECTION, with the purpose of nourishing the craft that is the quintessence of Paris couture (Reedy, 2009). This subsidiary has also recently taken acquired glove maker, Causse, and hat maker, Maison Michel. However, France is not the only focus of precious expertise, and the company recently bought Scottish cashmere maker Barrie Knitwear, who they have worked with for over 25 years and are the producers of Chanel’s iconic two-tone cashmere cardigans (BBC News, 2012). Chanel has also been securing their supply chain in regards to raw materials. The company recently purchased land near Grasse, dedicated to the cultivation of jasmine and roses for it’s No. 5 perfume. Furthermore, they re-introduced Florentine Iris to the area, as it yields a rare and expensive extract after several years for its No.19 perfume. In New Caledonia, they have also set up partnerships with sandalwood growers (Wendlandt, 2013). In addition, Chanel also acquired their long-time lamb hide provider, Bodin-Joyeaux (Wendlandt and Denis, 2013). It is the first tannery they have acquired, and is the provider of the supple, silky lamb leather used to make Chanel’s popular €1,500 quilt leather bags.
2.1.2) LVMH

LVMH Moët Hennessy Louis Vuitton, created in 1987, is world leader in high-quality products and possesses a unique portfolio of over 60 prestigious brands. The Group is active in five different sectors: wines & spirits, fashion and leather goods, perfumes & cosmetics, watches & jewellery, and selective retailing. LVMH is another luxury brand that is forging a strong presence in the field of acquisitions, and has made various investments over recent years. Since 2009, they have established their own Les Tanneries de la Comete, which is publicly committed to sustainable procurement of hides and skins, as well as in-house finishing techniques (Ricker, 2013). In 2011, they paid €47 million for 51%, in Heng Long Tannery, a Tanner of crocodilian leather since the 1950s, and also recently acquired Johnstone River crocodile farm in Australia (Wendlandt, 2013). Furthermore, in 2012, they bought Les Tanneries Roux, a French calf tanner. The leather segment was not their only focus in 2011, as they also bought 100% of shares of ArteCad, a Swiss watch supplier of mechanical movements, dials, cases and straps for €60 million (Wendlandt, 2013). The most recent and most significant acquisition by LVMH is the deal that took place in 2013 with Loro Piana. LVMH paid €2.7 billion for 80% of the top cashmere maker, which is also a brand positioned in the elitist segment, with the highest level of exclusivity and pricing, leveraging its heritage and image of top-quality yarns and fabrics, craftsmanship, and classic and relaxed elegance (Ortelli and Patel, 2014). In 1994, Loro Piana successfully patented the selling rights of the exclusive and exquisite Peruvian vicuna fibre. Previously, the Peruvian vicuna had only been used by the Peruvian emperor’s family, and now a Loro Piana’s vicuna coat is priced at around €14,000. The company has both a luxury goods division and textiles division, meaning this consolidation was both horizontal and vertical. The luxury goods division manufactures and distributes high-end menswear, womenswear, sportswear, and accessories. It generated 85% of its 2012 revenues through its retail network of 140 stores worldwide. The textiles division produces top-quality yarns mainly for internal use and also for third parties (Ortelli and Patel, 2014).

2.1.3) HERMÈS

A creator, manufacturer and trader of high-quality objects of exceptional craftsmanship, Hermès is active in the following sectors: leather goods and saddlery, men’s and women’s Ready-to-Wear, footwear, accessories, silk and textiles, jewellery and watches, perfumes, and interior design products. The main investments by Hermès International S.A. have been in the leather industry, with the company even creating a subsidiary called HCP, which stands for Hermès Cuirs Precieux. The company has gone to great lengths to invest in their specialty product leather, acquiring stakes Tannerie d’Annonay in 2013, one of its key providers of calf leather, which become one of the 30 manufacturers owned by the brand (Wendlandt, 2013). The brand also owns two other French tanneries, Gordon Choisy and TCIM (Tanneries de Cuirs Indochine et de Madagascar), and it is believed but not confirmed that they have controlling stakes in Tanneries.
Haas, whose leather quality, artisan know-how and craftsmanship is considered high value artisan products (Ricker, 2013). Besides France, the company also purchased Roggwiler Tannery in Lafayette Louisiana (USA), which tans and dyes crocodile, shark, stingray, ostrich, lizard, python and frog skins, as well as two crocodile farms in Australia, and the Michel Rettili tannery in Italy (Ricker, 2013).

2.1.4) KERING

A family-controlled, listed company, Kering is a world leader in apparel and accessories, which develops an ensemble of powerful brands. Kering, the luxury conglomerate formerly known as PPR, and owner of Gucci, Bottega Veneta, Saint Laurent, Alexander McQueen, Sergio Rossi, as well as sports brands Puma and Tretorn, has also been making moves in the leather industry. In 2013, Kering acquired majority stakes in the French tannery, France Croco, which is located in the Normandy region of France and specializes in producing high-quality tanned crocodile skins. The company was founded in 1974 and supplies skins to some of the most prestigious luxury brands in the world, including those owned by Kering and its competitors (Ricker, 2013). Additionally, Kering also bought Caravel Pelli Pregiate, an Italian Tannery, as well as a bankrupt tannery in Serbia, Ruma Fabrika Koze. It is suggested that this acquisition was done for tax incentives; supposedly Kering will receive €8000 for each of the 120 people they employ, the newly re-opened tannery would be called Luxury Tannery DOO (Ricker, 2013).

2.1.5) BULGARI

Bulgari has been creating renowned fine jewellery in 1884, and today it is a global and diversified luxury brand with a product and services portfolio of jewels, watches, accessories, fragrances, hotels and resorts featuring exceptional quality, an innovative style and impeccable service. Since 2000, Bulgari has been acquiring both key suppliers and competitors of its watch making sector such as Gerald Genta, Daniel Roth and Manufacture de Haute Horlogerie (Reedy, 2009). In 2005 the company bought controlling stakes in dial producer Cadrans Design, as well as Prestige d’Or, a specialist in metal watch straps, in 2007 they purchased intellectual property and machineries related to watch components from Leschot, and in 2008 purchased the Swiss company Finger, who specialize in high-end watch cases for multiple brands (Reedy, 2009). Bulgari has now secured and strengthened its manufacture of high-end dials, metal bracelets, cases and movements, and gained advantage over competitors.
While the afore mentioned companies are making a strong presence in the acquisition market, they are not the only brands taking part in this trend. There are numerous other brands like Swatch and Richemont who are also making moves to ensure that their companies are in charge of every aspect of production. However companies like LVMH and Hermès seem to be acquiring their suppliers at a much faster rate, and over various segments of the industry. After taking the above acquisitions into consideration, I was able to determine that the main areas of investment are in the sectors of skilled labor and traditional knowledge, leather and exotic skins, jewellery and watches, and cosmetics and perfume supplies.

2.2) AREAS OF INVESTMENT

The luxury supply market is highly volatile, with suppliers and prices of raw materials being subject to major fluctuations caused by climate changes and political issues. Furthermore, competition in the luxury industry is intense, and by selling differentiated products companies can achieve higher added value, and sell at higher prices. From the afore mentioned acquisitions we can determine that the main areas of investment among luxury brands in regard to vertical integration is in the sectors of skilled labor and traditional know-how, leather and exotic skins, cosmetics and perfume supplies, and jewellery and watches. Besides determining the sectors of investment, it is also necessary to explore the reasoning behind why these sectors have been the main focus in order to begin to understand the luxury brands’ motivations. I have tried to make these segments as logical and clear as possible, however some examples will tend to link to more than one segment.

2.2.1) ARTISANS & TRADITIONAL KNOW-HOW

Many luxury companies rely on the knowledge and skills of their manufactures that has been taught over many generations, sometimes with only one company being able to produce a certain product. If a company like this were to disappear, it would be detrimental to the supply of luxury goods to these brands. And the disappearance of these small artisanal companies is starting to seem like a good possibility; there were approximately 10,000 couture-level embroiderers in France in the 1920s, today there only around 200 (Reedy, 2009), this means that the demand for these ateliers services has decreased dramatically. Moreover, since the 80s, Swiss watch making technicians have had to face the advance of Asian competition, and the emergence of quartz technology, and they are still in jeopardy today as the market for high-end timepieces is on the decline (Reedy, 2009). If the demand for the skilled labor that these companies provide continues to decrease, the companies will be sure to die out. By acquiring these artisans, the companies aim to secure the knowledge and craftsmanship that they provide. However, know-how is not only sought after when it comes to small ateliers and technicians, but also big manufacturers that may be world leaders in manufacturing and distribution, as can be seen from the LVMH
purchase of Loro Piana. The company manufacturers and distributes high-end textile products and has acquired its experience over six generations. It specializes in production of high-end, luxury cashmere and wool products made in Italy, combining the latest technology with traditional craftsmanship and Italian tailoring (Lvmh.com, 2013).

2.2.2) LEATHER & EXOTIC SKINS

Leather is at the core of many famous luxury clothing brands, and prices of these raw materials have been soaring since 2008/2009, with the barrier of $100 a hide being broken last year (FNA, 2013). Due to the demand of the luxury sector, the prices of exotics, Spanish entrefino, and French calf leather have been rising sharply. These rising raw materials prices, especially for premium selections, is only one issue; overall slaughter numbers have decreased due to the trend of more people becoming vegan and vegetarian (Daneshkhu, 2013). If we look specifically at Hermès, calf leather is their number one raw material, and they are facing a dwindling supply because meat traders are responding to a drop in consumer demand for veal, therefore fewer animals are being reared and slaughtered, however the demand for luxury leather goods is still growing, and the prices are therefore rising by 20-30% per year (Daneshkhu, 2013). For Hermès, raising their own calves does not make financial sense as 80% of the animals value is in its meat, and only 1 or 2 skins out of 10 is good enough quality for an Hermès handbag, therefore the company is looking into protecting their supply chain by financing vaccines against ringworm in order to reduce the amount of scars and ensure more hides are in pristine condition (Wendlandt, 2013).

There is a high demand for luxury leather goods worldwide, especially in the BRIC nations, and more particularly China. This has resulted in a struggle among tanneries for the higher quality materials that are used for leather goods and high-end footwear, such as box calf, soft nappa, nubuck, and full aniline. Additionally, consumer demand for reptile skins, in particular snake, crocodile and alligator, has risen substantially over recent years, high grade crocodile skin can cost several thousand euros, and it takes belly skin from three porosus crocodiles (which has regular scales and is therefore the most sought after) to make one Hermès Kelly bag which sells for about €30,000 each (Wendlandt, 2013). The alligator and exotic skin industry in Louisiana is dealing with an unstable inventory of exotic skins, with a surplus of 840,000 hides waiting to be sold, while only about 275,000 hides are sold nationally in the US each year, which results in a threat to the stability of the sourcing of skins (Reedy, 2009). In 2009, Lariviere stated that Hermès had been buying skins from farmers at prices far lower than in the past, and lower even than the price of raising an alligator. This could have been attributed to a very bad market, as farmers are hugely dependent on luxury watch sales which were off by as much as 25 percent.

However, farmers suggested something else was going on, being offered very little by tanneries
for their raw product, while at the same time fashion houses were complaining about the astro-
nomical prices for tanned hides (Lariviere, 2009). Many labels gave up and moved away from
alligator altogether, and this could be one of the main reasons that pushed luxury brands like
Hermès to start investing in their supply of exotic skins, because for luxury brands, almost 10% of
the total revenue from handbag sales is from exotic animal skins, and according to Bain & Co the
luxury accessories market was worth €57 billion last year, Bloomberg (2013).

2.2.3) COSMETICS & PERFUME SUPPLIES

Chanel, Dior and Hermès have been setting up exclusive partnerships with plant growers in an
effort to guarantee the supply of raw materials for their perfumes and cosmetics. Dior had deals
with Swiss and African farmers, and also purchased land near Grasse, the perfume capital of
France, dedicating thousands of hectares to the cultivation of jasmine and roses. Chanel also
grows jasmine and roses for it’s No.5 perfume near Grasse, and even built extraction machines
in their fields to avoid bruising of the flowers. Furthermore, Chanel has re-introduced Florentine
Iris, which takes several years to produce a rare and expensive extract for their No.19 perfume.
They have also set up a partnership with a sandalwood grower in New Caledonia (Wendlandt,
2013). There has not been much information available on the reasoning for this interest in agricul-
tural farming of cosmetics supplies, however Edouard Mauvais-Jarvis, scientific communications
director at Parfums Christian Dior stated that, “Our concern is ensuring continuity in the equity of
the products we use and being able to trace them.” (Wendlandt, 2013). Most likely, their concern
for continuity of agricultural products is brought about by global warming issues.

2.2.4) WATCHES & JEWELLERY

In 2011, LVMH announced that it has acquired 100% of the shares of ArteCad SA, one of the
leading manufacturers of Swiss watch dials, enabling LVMH to further reinforce its industrial
integration in watch-making and guarantee its independence in the strategic area of watch dials.
ArteCad SA manufactures more than 350,000 watch dials a year and supplies LVMH brands as
well as numerous other prestigious Swiss timepieces manufacturers amongst its clients, all of
whom it they will continue to supply (Wendlandt, 2013). ArteCad is known for its integrated ex-
pertise across all dials manufacturing processes, for its unique innovation capability as well as its
rapid prototyping. Gem Palace, India’s premier jewellery house have implemented a completely
vertically-integrated manufacturing unit, which includes sourcing, cutting, design, mounting, and
retail of their own designs. Their aim is to revive traditional skills that were nearly lost in history
(Reedy, 2009). Laurence Graff, London based jeweller, has focused on controlling access to raw
materials. With the belief that the highest quality will attract the best customers, the company is
focused on catering to the desires of the extreme upper-tier. In order to satisfy this clientele,
the company is involved in all stages of production, like Gem Palace, but they have also begun mining their own stones. The company bought a minority stake in the Letseng-la-Terai mine in Lesotho in 2008, which is where the famous Lesotho Promise (the 15th largest rough diamond ever to be discovered) was found (Reedy, 2009). This investment underscores the companies desire to be an industry leader, with access to some of the most superb stones in the world, and has ensure market dominance for many years. To Laurence Graff, the access to coloured stones is just as important as their stone cutters and master jewellers (Reedy, 2009).

From the above examples a conclusion can be made that the main areas of investment have been: in know-how and artisanal skills that are currently under threat of being lost in history and brands are wanting to secure this know how and expertise, in leather and exotic skins that has soaring prices and threatened stability of sourcing, in the supply of cosmetics and perfume ingredients as a way to ensure continuity and equity, and in the watches and jewellery segment both as a way to save traditional knowledge and secure supply.
SECTION 3
3.1) BRAND MOTIVES

Various reasons have been given by brand representatives for their integration strategies, which differed depending on the segment of investments as well as the brand specialties. By taking the above conclusion into consideration regarding which areas are being invested in and possible reasons why, we can then begin to understand the reasons that brands give for the acquisitions that have been made.

In regards to the segment of skilled labor and artisans, Chanel has had the most dominant presence of acquisitions. Senior press officer for the Maisons d’Arts, Nathalie Vibert claims that the acquisitions of French ateliers by Chanel:

“amount to a genuine wager on creativity, which, beyond preserving unique archives and know-how, allows such craftsmanship to grow and bloom in full independence. The aim is clear: it is not for Chanel to grab exclusive suppliers, but to nourish a craft which is the quintessence of Paris couture. Nor is it to save the last remnants of disappearing tradition. To the contrary, all highly profitable at the time of their purchase, these firms can now look at the future with hope and serenity.” (Reedy, 2009).

Furthermore, after the purchase of Scottish cashmere maker Barrie Knitwear, producers of Chanel's iconic two-tone cashmere cardigans, the label's fashion president Bruno Pavlovsky explained that through this acquisition, Chanel is reaffirming their commitment to traditional expertise and craftsmanship, with the aim of safeguarding their future and supporting their development (BBC News, 2012). From these statements it can be determined that the preservation of heritage and craftsmanship is very important to Chanel. When considering that Chanel is an elitist luxury brand, which is highly associated with heritage and craftsmanship, it is possible to see how the acquisitions of these long established ateliers ties into Chanel’s brand narrative.

Within the leather and exotic skins segment, Hermès has given various motives for their numerous acquisitions. After acquiring Tannerie d’Annonay, Hermès explained that the acquisition is in line with the company’s strategy of preserving and developing sources of supplies and the know-how that is related to them (Ricker, 2013). The head of manufacturing and equity investments at Hermès, Guillaume de Seynes explained that the company is ready to make the necessary investments when the know-how or raw materials associated with the quality of their products is threatened (Wendlandt, 2013), which further establishes this strategy of preservation. This need to preserve critical resources is becoming ever more present and luxury brands are capitalizing on vertical integration as a means of doing so. Deputy chief executive for strategic development and corporate image at Hermès, Patrick Albaladejo described that the preferred model for Hermès is to secure partnerships with trusted suppliers, however he explained that when there is a tightening in the market, and if the company has a source that would be difficult
to replace, then purchasing is the ultimate way to guarantee supply over time (Daneshkhu, 2013). In regard to leather, Albaladejo expects sourcing of the best quality leather to remain problematic, saying that:

“good quality calf skin depends on the breeding of the animal; if it is not raised in good conditions – in freedom and eating grass – it will not have a good life and the skin will not be at the quality required. Unfortunately, the quality of breeding is not necessarily going up these days.” (Daneshkhu, 2013).

The concept of applying high standards of breeding to ensure the best quality skins is seen as an intrinsic part of the industry. Paul Batigne, council chairman of the French National Leather Council explained that if cows are reared under the best conditions of practice, the supply of first-class leather would rise spectacularly, Daneshkhu (2013). However, reasons for acquisitions within the leather industry can also be linked back to some of the reasons given for the purchases of ateliers, specifically as a means to secure expertise. It was stated in a company press release by Hermès that:

“Hermès Cuirs Précieux, the tannery division of the Hermès International group, had become the only shareholder of the tannery d’Annonay, recognized for the quality of its expertise in calf leather and notably the Box Calf, Hermès’ iconic material since its origin. This acquisition is in line with the strategy of the Hermès Group in the preservation and the development of its sources of supplies and of the know-how related to them.” (Hermès, 2013)

Another example of this strategy of preservation and development by Hermès is the purchase of Roggwiller Tannery. This deal will guarantee that the most exclusive variations will not be endangered by an unstable inventory, and the director of Roggwiller, de Reynies, is expecting their employment to double over the next few years as Hermes boosts their production capabilities (Reedy, 2009).

Hermès has not been the only luxury brand to invest in this segment, and the reasons given by their luxury competitors have been much the same. After the acquisition of Bodin-Joyeaux by Chanel, fashion president Bruno Pavlovsky stated that they wanted to preserve the know-how of the company who are lambskin specialists, he explained further that they will continue to supply rivals, as do other Chanel suppliers (Reuters, 2013). After purchasing France Croco, Kering divulged that their reason for this acquisition was to secure a sustainable supply of high quality crocodilian skins, and the company also plans to maintain France Croco’s current suppliers and customers, with the current CEO, Dan Lewkowicz, remaining in his position at company.
(Daneshkhu, 2013). The company has also stated that vertical integration is part of Kering’s strategy to support its brands in better reaching their potential." (Phelan, 2013). In regard to the acquisition of Heng Long Tannery in Singapore, Bernard Arnault, chairman and chief executive of LVMH, was quoted telling shareholders, ‘we don’t want to find ourselves in a situation where we might be short of supply.’ (Daneshkhu, 2013). It can therefore be determined that the main reasons given by luxury brands for their interest in the leather and exotic skins segment is as a way to guarantee their supply of the highest quality skins, which a becoming a problem due to the decline of meat eating in Western society, as well as poor breeding environments or diseases that cause scarring among the animals. Furthermore, the prices of leather and exotic skins products have been soaring, pushing brands to invest as a way to curb these high prices. Additionally, luxury companies want to preserve the know-how and expertise of their suppliers.

The preservation of quality and expertise is also a major motive within the jewellery and watch sector. One of the main players in jewellery and watch acquisitions is Bulgari, whose managing director, Guido Terreni stated that: “Bulgari has strongly integrated its production in watches, passing from designer and assembler to a Manufacture de Haute Horlogerie able to produce all the strategic components of a watch at the highest level of competence.” He went on to explain that, ‘Integration for us was born from a desire to master the know-how and increase the competence of the product and now it has become a precious manufacturing tool that allows us to excel in quality and ensure independence in the supply.’ (Brooke, 2014).

This statement further establishes the strategy of preservation of knowledge being used by many brands. However, besides preservation, another strategy that is of interest is the revival of knowledge. One of the companies who demonstrates this strategy is Gem Palace. Sanjay Kasliwal, firm principal at Gem Palace explained that their company is training craftsmen to do work that is dead, such as 18th century settings of rubies and emeralds cut in a mosaic manner. Their belief is that if it was done in the 18th century, then if you put enough time and effort into it today, it can still be done (Reedy, 2009). Gem Palace believes that craft is an integral part of their brand identity and business model, and having control over their highly-refined production means that they can create more varied and unusual designs. And even more interestingly, Gem Palace is able to offer their services to other jewellery companies who do not have access to the same skill sets, which gives them a competitive advantage. Furthermore, they can offer assistance to other companies, supplying everything from loose, uncut stones, to a designers entire production.

And in relation to their own products, the company estimated to having 30 to 40% lower cost margins (Reedy, 2009). The success that resulted from their revival of traditional skills had lead to the company wanting to open an educational institute focused on the traditional art of jewellery-making, which will foster skilled labor for the future. It can therefore be established that upward
vertical integration in the jewellery and watch sector is mainly due to the desire by brands to preserve or revive the know-how surrounding their product offerings, as well as to increase competitiveness.

By taking the previous two sections into consideration, it was possible to extract the main reasoning that brands have given or displayed through action, for why they have moved forward with upward vertical integration strategies. The main reasons so far for why brands are vertically integrating their supply chains are:

- the necessity to serve fast growing demand
- to guarantee and maintain the best quality
- to preserve or revive know-how and the ability to train craftsmen for many years (knowledge protection)
- to have control over the whole process of product development and distribution
- to have control of costs, timing, shipping, inventory
- brand prestige
- efficiency and flexibility

We can therefore determine that there are similar motives among all sectors of investment. Luxury brands are focusing on ensuring that their production is of a high and constant quality, and that they are preserving the specific know-how that is essential to their product offering. By integrating suppliers luxury companies have greater control over the chain of production, which enables them to ensure the integrity of the final product, and simultaneously increases profits by cutting out the middle man or enabling them to supply other companies.

3.2) ADDITIONAL BENEFITS OF SUPPLY CHAIN INTEGRATION

While luxury brands have made numerous statements about the motives behind investing in their supply chain, these may not be the only reasons for their acquisitions. With each acquisitions comes the ability to curb the risk of production delays, diminished quality-control, and spiralling costs, therefore providing a form of insurance when no one can predict where things are headed. Mario Ortelli said that, "[vertical integration] gives you a competitive advantage, raises barriers to entry, and underscores the image of your high quality products." (Astrid Wendlandt, 2013). The benefits that could come from vertical integration will be investigated, in areas such as: the assurance of supply and quality, the assurance of ethical and sustainable practices, prevention of counterfeit goods, competitive advantage and creation of barriers to entry, the potential to keep skills and resources alive, cost reduction and profitable self-interest.
There are various benefits that come from supply chain management, and the clearest explanation that I found for these benefits was one that divided into four categories, which I believe creates a very clear understanding of how the different segments of a company stand to benefit from supply chain management. The segments are: suppliers and inventory management, business management, customer satisfaction, and business growth (Supply-chain-management.acctivate.com, 2014). Each segment and its specific benefits are listed below:

**Supplier & Inventory Management:**
- Balance service levels with stocking levels
- Gain company wide, real-time inventory visibility
- Forecast with accuracy and predictability
- Reduce lost sales due to out-of-stock products
- Gain control over inventory investments and costs of goods sold
- Inject speed and flexibility into the order process
- Increase on-time, error-free deliveries

**Business Management:**
- Gain visibility across all areas of your company
- Make faster, better decisions with real-time information
- Assign, track & monitor issues, events and projects
- Proactively identify and correct issues
- Explore, uncover and analyse decision alternatives
- Get real-time business status at any time

**Customer Satisfaction:**
- Equip the entire company with CRM tools; sales, customer service, collections; all customer facing personnel
- Identify most profitable customers
- Measure sales and service performance
- Improve quality of customer inquiry responses
- Discover customer insights, preferences and trends

**Business Growth:**
- Handle substantial business volume and growth
- Integrate seamlessly with best in class technologies
- Open access database for desired use
- Extend capabilities without major system changes
- Employ local and global staff on system
This list is very specific and extensive, and while most benefits could in some way be relative to the motives behind certain acquisitions by luxury companies, I do not believe that they are the major reasons that caused these brands to vertically integrate. For example, being able to improve the quality of customer inquiry responses may be a nice bonus of vertical integration, however it would not likely be a reason for a company to invest millions of Euros into an acquisition. Therefore, taking these possible benefits into consideration, I combined my findings from the areas of investment, the reasons given by brands for upward vertical integration, the interviews that I had with industry experts, and my own observations to come up with possible benefits that are more specifically related to the luxury brands that have been analysed which are explained in the following section.

3.2.1) PRODUCT PROVENANCE

Product provenance is becoming increasingly important as traceability is a top priority. In the jewellery industry this is especially in regard to the controversies around blood diamonds (Spheralife, 2014). And in the fashion industry in regard to treatment of labor and animals when obtaining materials. During my internship at Acne Studios, the was a video posted by PETA showing very cruel treatment of angora rabbits, with their hair being yanked out of their skin as opposed to being shaved. No one knew where this video was taken, nor had any of our knitwear suppliers ever heard of such cruel treatment. However, because our manufacturers could be sure how the animals were treated where we obtained the angora yarns, Acne Studios took all angora products off the shelves. After a few weeks we received pictures of the animals, the facilities, and of how the staff shave the rabbits, as well as certificates and signed documents from the suppliers to prove that the rabbits are treated in an ethical manner. Nonetheless, Acne Studios lost a lot of sales by taking so much product off the shelves, as well as having to deal with the negative publicity associated with angora products once the video was posted. It is a lot easier to ensure sustainable methods in production and ethical treatment of employees when you own the company. By gaining controlling shares over their suppliers, luxury brands would be able to gain clear understanding of exactly where their products are coming from and how they are being made. Not only will this help brands ensure that ethical methods are used, but it will also lead to higher quality products in some cases. For example, it was mentioned above in a quote by Albaladejo that:“good quality calf skin depends on the breeding of the animal; if it is not raised in good conditions – in freedom and eating grass – it will not have a good life and the skin will not be at the quality required. Unfortunately, the quality of breeding is not necessarily going up these days.” (Daneshkhu, 2013). The same could be said for crocodiles and alligators, which need to be bred in enclosures with enough space to keep their jaws off each other, they need to be bred in a calm environment in order to yield high quality skins (Bloomberg, 2013). By gaining control of their suppliers, it may also lead to a higher level of transparency among luxury brands, which could
result in higher brand loyalty from customers because they can be assured of ethical practices and high quality products. Thus, knowing exactly where their raw materials come from, and how they are yielded and manufactured, is very beneficial to a luxury company’s profitability and brand image. Additionally, product provenance is not only an important issue among consumers regarding ethical and sustainable practices, but also because of the stigma attached to the “Made In …’ label. A survey done by the Boston Consulting Group, highlights that 78% of consumers check where the luxury products are made, and it is noted that “Made in Italy” outperformed “Made in France” (Ortelli, 2014). When I interviewed Franck Delpal, one of the reasons he gave for vertical integration by luxury companies is that they can support the industrial basis and keep production in Europe, which is in line with the fact that consumers value product origin.

3.2.2) ASSURANCE & CONTROL OF PRODUCT SUPPLY & QUALITY

Having control over the supply and quality of products is an important asset for luxury brands. Senior research analyst of European luxury goods at Sanford C. Bernstein Ltd, Mario Ortelli, expressed that:

“big luxury groups have plenty of cash at the moment and they want to use it constructively, vertical integration gives them greater quality control over the whole production and retail process and that’s very important in this sector. There’s also a scarcity of raw materials in many areas and so companies that own their suppliers are in a stronger position than their competitors.” (Spherelife, 2014).

Furthermore, Rob Langtry, head of marketing for Australian Wool Innovation, suggests that the acquisitions made by LVMH have a strong product base to them, highlighting the recent acquisition of Loro Piana who are almost ‘fanatical’ about the quality of the ingredients they use (Marian, 2013). The same is true for another brand in which LVMH has a share, RM Williams, the Australian shoe and outdoor clothing label whose reputation was built on leather skills, based on sourcing the product and then following that product through from its raw state to its finished product with very strong artisanal skills. Langtry foresees brands going back down their supply chain in order to ensure that the product supply backs up the luxury (Marian, 2013). When interviewing Mario Ortelli he said that one of the main reasons for vertical integration by luxury brands is because:

“specific production activity is becoming scarce, and therefore it is very important to try and secure it, like exotic skin for example, there is a bottle neck on the supply. Or in the watch industry where you have to wait weeks to get dials, so you are stuck with inventory.”
As mentioned above, having control over the supply chain is a great way for brands to ensure that they yield the highest quality products, however when considering that many of the acquired companies we have seen so far have been long time suppliers of the luxury brands, one would assume that quality is not an issue. Nonetheless, by securing the supply from these brands, they are also ensuring the quality of their product offering as the luxury brands will not be forced to look for alternative suppliers or manufacturers in the future. With upward vertical integration being such a trend amongst luxury companies there is the risk that once traditional, specialised manufacturers have been acquired, the large luxury groups will prevent them from supplying the competition, however not only would this damage the artisanal skills they are promoting but it would also cut into the profit margins of their newly acquired companies, which would not go down well with shareholders, and therefore the luxury brands have made numerous statements ensuring that they will continue to supply their competitors. Notwithstanding, luxury companies would not want to face the possibility of having their supply cut off, and they need to invest their money in a constructive way, therefore consolidation of their suppliers is a strong investment which simultaneously helps fortify the quality and supply of their luxury goods.

Having control over your supply chain does not only mean ensuring your supply of raw materials, when I interviewed Henny Jordaan he noted that when you have control over your supply chain you know everything much more up front, which means you can plan and predict better. Especially when selling to retailers through wholesale as you need to let customers know when things will be available. In this way having control of your supply is very beneficial to a business.

3.2.3) PREVENTION OF COUNTERFEIT GOODS

Counterfeit goods are at present a major issue for luxury brands, and I therefore speculated as to whether the ability to prevent counterfeit goods may be one of the underlying motives behind why brands are vertically integrating their supply chains. Pring (2013) stated that manufacturers need to exercise higher vigilance over their supply chains in order to stem the flood of counterfeit goods reaching consumers. Many companies are dealing with damage to their brand reputation as well as a loss of revenue due to not knowing what is happening in their complex supply chains. He explained that according to Mark James, of PwC’s anti-counterfeit team, manufacturers that they had spoken to have a legitimate concern about ‘backdoor production’, which is for example when an order is placed with a supplier for 10,000 pieces, but an extra 20,000 are also produced and sold separately, or suppliers take the knowledge gained through manufacturing these items and then set up their own factories. However, after reflecting on this proposal it became clear that this type of counterfeiting is more related to the alcohol industry, and usually the suppliers of luxury goods that have been invested in so far by our luxury brands are very high end and would not conduct in counterfeiting operations, therefore it does not seem likely that any
of the acquisitions have been made for this reason. Notwithstanding, while this category may not be highly relevant regarding the current acquisitions, we may see future acquisitions by luxury brands in other segments that have so far not been explored, and anti counterfeiting could therefore become a benefit of supply chain integration.

3.2.4) REDUCTION OF PRICES & COSTS

When it comes to investing in their supplies, one of the major benefits for companies is that they are able to control the prices they pay for important materials of luxury goods, and costs can be regulated even further by cutting out the middleman. Like we saw previous in the example of crocodile farmers being paid very low prices for their products, whilst fashion houses were complaining of significantly high prices from the tanneries. With Hermès having bought into both tanneries, as well as farms, they do not need to be concerned with sellers grading skins up to get better pricing, nor with buyers grading skins down to get lower prices. Their main focus can be on yielding the highest quality skins which they can then manufacture into luxurious products. Furthermore, when it comes to the supply chain, Henny Jordaan explained that:

"the timing to get everything right is all logistics, the same as with cooking on programmes like Masterchef, how they are able to get everything done in the time frame. Logistics can help save you a lot of money, for example Zeeman has over a year of lead times for some of its products, so they can use slower modes of transport, save costs for storage in a warehouse. It helps the overall logistical scheme."

Urban (2002) stated that it is inventory levels, not transportation costs, that drive supply chain savings. For most manufactured products, transportation makes up only two to five percent of total costs, whereas, raw materials, components, and subassemblies typically make up 55 to 75 percent of the total costs. Therefore, having complete supply chain transparency creates the ability to reduce raw material and finished goods inventories, resulting in large cost savings. This relates back to the benefit to having control over your supply, as companies will not need to over purchase stock for fear of not being able to get it in the future. With the above being taken into consideration, it can be determined that by having full control over the supply chain, a company is able to optimize efficiency and effectiveness, which means they can save costs along the entire chain of logistics.
3.2.5) BRAND ETHOS - CRAFTSMANSHIP, HERITAGE & INNOVATION

When I interviewed Mario Ortelli, he stated that one of the reasons for upward vertical integration by luxury brands is because these days luxury goods have to be more exclusive in order to meet the clients' perception; heritage and craftsmanship are something that consumers value more and more and investing in their supply chain is one way for luxury brands to secure this. In the 'Summary call of the Blackbook – True Luxury Global Consumer Insight' it was stated that introvert values such as quality, exclusivity, craftsmanship, and timelessness are likely to return to the forefront of intrinsic values in the upcoming decade compared to extrovert values such as adorned aesthetics, brand visibility, customization, and being cool/sexy, and focusing on introvert values is paramount to allure consumers (Ortelli, 2014).

Heritage and innovation are two key factors that give a brand a competitive advantage, and both aspects are influenced by supply chain. Many of the ateliers being bought by luxury brands are family owned businesses that have been around for many years, which further builds and strengthens the brands' association with heritage. Innovation is also related to the supply chain in terms of needing the abilities and flexibility to create innovative designs. It should be noted that the most successful luxury brands feature both heritage and innovation, offering product continuity, while constantly adapting their offering to consumers' changing tastes and fashion trends (Ortelli and Patel, 2014). They do not only focus on craftsmanship, but also invest in research & design to produce state-of-the-art items. Depending on its positioning, each brand has a different mix based on its focus on heritage and innovation.

One of the key attributes of a top luxury brand is heritage; the most renowned and valuable luxury brands are also the oldest. It is thus important for a luxury brand to be associated with a distinctive brand history, with deep roots and tradition, and with a proper place of origin. In order to be perceived as a true luxury brand, a company needs to prove its exclusivity, quality, and timelessness. In fact, seven out of the world's top 10 luxury brands are over 100 years old, with the top two, Louis Vuitton and Hermès, being more than 150 years old, while the newest one, Coach, was established around 72 years ago (Ortelli and Patel, 2014). Brand heritage also refers to the distinctive style and ethos of a brand, which cannot be created overnight. The resurrection of the Bottega Veneta brand from the early 2000s is a good example of this. 66.67% of the company was acquired by the former Gucci Group when the brand revenue was €48 million and the brand was struggling. After the acquisition, Tomas Maier was appointed the creative director of the brand who introduced the four cornerstones of the brand: fine quality materials, extraordinary craftsmanship, contemporary functionality, and timeless design. Since then, the company has developed the high-end luxury leather goods brand, with 2012 reported sales of €945 million, and EBIT margins of 32% which is even higher than Gucci (Ortelli and Patel, 2014). Most luxury brands with a strong heritage often have a core expertise in either leather (LVMH, Chanel, and Bottega Veneta) or watches (Cartier, Omega, and Rolex). But the opposite is also true,
heritage and craftsmanship are more important for leather and hard luxury than other luxury product categories. ‘Louis Vuitton, Prada, Gucci are trying to elevate the level of perceived exclusivity of their brands, and exotic-skin products really help in this,’ said Mario Ortelli, and after LVMH’s purchase of a farm this year and Kering’s of a tannery, and he expects they will continue to make selective acquisitions (Bloomberg, 2013). This statement further established the fact the one of the main reasons for brand acquisitions is because of the brand image of exclusivity and craftsmanship. When I interviewed Mario Ortelli, the main reason he gave for why brands are investing in their supply chains is because heritage and craftsmanship are something that consumers value more and more, and investing in their supply chain is one way for luxury brands to secure this. This association with heritage and craftsmanship can be further established by investing in companies with traditional skills and expertise that have been established for many years.

To be successful and engage with the consumer, brands must be innovative, and having control of their supply of raw materials and manufacturers strengthens a brand’s ability to do this. Fashion content is an important part of innovation concerning the product offerings for soft luxury. Whereas for hard luxury, innovation relates more to the technical component such as watch complications. By acquiring the knowledge and skills of suppliers that are experts in the industry, luxury brands are able to take advantage of their craftsmanship skills and produce highly innovative products. Innovation is also a critical part of the selling channels and luxury companies have been launching creative, new formats of directly operated stores to exploit the advantages of having control of their manufacturers. Consumers are not just looking for a luxury product but for an experience, and the big corporations who are regularly accused of being ‘factories’ rather than artistically driven collections are now acquiring the small, long-established artisans with the traditional skills that are critical to their luxury products, and they want to show them off. Companies such as Gucci, Smythson and Vacheron Constantin have been displaying the skills of these craftsmen and women in their stores as a way to show off their credentials, thereby combining both heritage and innovation (Brooke, 2014). This also ties into the section of product provenance as it further establishes that sophisticated consumers want to develop their knowledge of the high-end brands that they buy from, they are interested in knowing where the products came from, or how they were made. More than selling a product, luxury brands sell a story, and this story becomes more clear when consumers understand the origin of the products they are buying.

Moreover, customization also plays an important role in alluring consumers towards exclusive and bespoke products and brands have begun offering personalization of their luxury items for their clients (Ortelli and Patel, 2014). Some examples of this include the Louis Vuitton bags that customer initials can be printed on, Cartier rings in which you can engrave a name or a date, and Burberry trench coat in which you can add your name next to the label. Furthermore, the increased importance of men’s tailoring and ‘made-to-measure‘ is notable for all brands (Ortelli and
Patel, 2014). The ability to customize products is made much easier when brands have control over their manufacturers. Therefore a major added benefit of upward vertical integration is being able to create innovative products and offer customization to clientèle.

Consumers are looking not just for a luxury product but for an experience. It is thus paramount to have seamless integration across different channels, and each of the channels must be coherent with the luxury brand values and convey the same brand message. In an industry that is focused on exclusivity and craftsmanship, and is at the same time influenced by fashion trends, it is important to thus carefully balance heritage and innovation.

3.2.6) COMPETITIVE ADVANTAGE

There are many competitive advantages that are established when a luxury brand consolidates with their suppliers, most can be related back to the previous aspects of having control over quality and supply, or having product traceability, however there have been concerns raised as to whether luxury brands will take advantage over their competitors by cutting off their supply from the companies that these luxury brands have acquired. While this strategy may be a good way to sabotage a competitor, it is also a form of self sabotage for the company as they will be losing possible income from their competitors. Luxury brands have stated that the suppliers they have acquired will continue to supply their competitors, explaining that it helps to breed creativity. However, this might also be because supplying these luxury products helps to increase scalability, and the acquired companies need to be profitable in order to satisfy shareholder demands. When asked why companies have invested in certain segments but outsource in others, Mario Ortelli explained that outsourcing is a matter of complexity, many suppliers of ready to wear exist in the industry, and production needs to be scalable in order to use certain machinery and meet the volumes. Therefore, brands usually invest in companies with more continuity like embroiderers or exotic skins, and it is usually very high end companies that they buy into as they control the sources of the values of craftsmanship and innovation. When asked if he thought luxury companies would really continue supplying their competitors, Ortelli explained that they would continue to supply their competitors because luxury brands do not usually produce enough volumes to stay profitable when they do not supply other companies. Therefore, it helps a company to be more profitable, it is always better to sell to competitors. And in regard to the rumour that Swatch may be cutting off their supplies, forcing companies like Richemont and Kering to look for alternative sources, he explained that:

“Swatch will not cut off all supplies to their competitors, they only want to continue supplying certain companies because entry level brands don’t invest in building production capabilities in order to gain a successful market share and therefore they don’t
have the pricing power, so if you look at companies selling the omega replica, it is like they are selling a fake BMW with a real BMW engine. Swatch will always sell to Cartier for example, so they will not cut off the supply, they only want to sell to specific high end brands with the pricing power to support the watch movements."

From this information it is possible to deduce that luxury brands will rather continue selling to their competitors because it brings in higher profits, however they should be strategic in regard to the type of companies they supply in order to maintain the exclusive aura of their products. The main ways that luxury brands gain competitive advantage through supply chain management can therefore be extracted from the previous sub sections: by creating transparency, reducing costs and therefore creating higher profit margins, by having control over the supply and quality of luxury products, and by strengthening their brand ethos of heritage and craftsmanship.

3.2.7) ECONOMIES OF SCALE

Another benefit that may result from vertical integration of the supply chain is economies of scale. The Bernstein M&A Blackbook (Ortelli and Patel, 2014) combines an analyses of historical, as well as potential M&A deals in the luxury sector, to support their view on further consolidation of the luxury sector. In that report, it is asserted that luxury consolidation is fostered by four main drivers: economies of scale, synergies, cash position and funds interest. Synergies are more relative in regard to consolidation through horizontal integration where brands can take advantage of higher potential revenue and costs synergies on the back of advertising, real estate, and product development synergies in particular. Therefore, this is more relevant for the acquisition of another luxury brand, for example the LVMH deal with Loro Piana. Thomas Chauvet, a Citigroup analyst in London stated that:

"This should be viewed as a positive, opportunistic deal for LVMH as Loro Piana has a potential to grow sales and Ebit significantly in the niche, fast-growing luxury daywear segment as well as creating some industrial synergies with the rest of LVMH's fashion and leather brands." (Roberts, 2013).

However, as most of the acquisitions that were explored in this research report were with suppliers as opposed to retailers, it is necessary to consider economies of scale, which is more relevant in terms of consolidation through vertical integration, and is therefore a more viable motive for luxury brands to vertically integrate.

Low volumes of luxury products do not allow for economies of scale, and therefore acquisitions that lead to a stability of supply costs also help luxury brands refrain from having to increase
their manufacturing in Asia. Brand image is very important for luxury brands, and it is critical that consumers are not affected by the 'Made in China' type of labelling while paying a premium price for a product. In other words, offshoring products to low cost countries can mean a shift in the target positioning of a brand. Products in the luxury segment should be manufactured with geographical reason, hence Italy for leather goods and shoes, and Switzerland for watches (Ortelli and Patel, 2014). The scale advantage comes through being able to stabilize costs by producing high volumes, which luxury brands are able to control once they have transparency into the supply chain. This benefits both the supplier, who reaches high volumes, and the luxury brand who is able to keep production in Europe.

Considering the above information, it is possible to establish that product provenance, control of quality and supply, pricing and cost reduction, craftsmanship and innovation, competitive advantage, and economies of scale are viable reasons as to why a luxury company may decide to vertically integrate their supply chain. On the other hand, the prevention of counterfeit goods is presently not a likely a reason for the current acquisitions that are taking place.
4.2) CONCLUSION

The aim of this report was to explore the reasons behind the trend of vertical integration by luxury companies. An investigation by means of literature research and corporate interviews took place in order to discover the main sectors of investment, and the advantages of securing these resources. Firstly, the active brands in the segment were analysed, with some of the main brands who have been investing in their supply chains coming to fruition. These brands were Chanel, LVMH, Hermès, Kering and Bulgari. Each brand and its various acquisitions was studied. The results of this section of the research report were that:

- Chanel has been very active in the segments of ateliers and manufacturers, cosmetics and perfume, as well as leather goods.
- LVMH has been focused on acquiring manufacturers, cosmetics and perfume supplies, and leather goods, and they have additionally been active in the hard luxury segment with watches.
- Hermès has not been as varied in its acquisitions as the other brands, however it has been the most numerous in regard to its acquisitions in the leather and exotics skins sector, purchasing shares in various tanneries and crocodile/alligator farms around the world.
- Kering is another brand that has been very prominent in the leather goods sector.
- Bulgari has been acquiring manufacturers of high-end dials, metal bracelets, cases and movements.

After studying the various deals that took place between luxury brands and their suppliers, it was possible to conclude the main areas of investment. Firstly, brands tend to frequently invest in artisanal companies with traditional know-how. Many luxury companies rely on the knowledge and skills of their manufactures that has been taught over many generations, and these manufacturers have been diminishing in quantity over the decades, which can be seen through the fact that the 10,000 couture-level embroiderers in France in the 1920s has been reduced to only around 200 today. Secondly, the leather and exotic skins segment has been a major consolidation focus of luxury companies. Leather is at the core of many famous luxury clothing brands, and prices of these raw materials have been soaring over recent years, and this coupled with a shortage in supply as well as diminishing quality of skins is a major concern for all luxury brands specialising in leather goods. A third area of investment has been in the supply of cosmetics and perfume ingredients, with brands like Chanel and Dior buying land to cultivate production jasmine and roses as a way to ensure continuity of their products. Lastly, the jewellery and watch industry is another big investment sector, with brands investing in everything from reviving traditional techniques to diamond minds in Southern Africa.

After the major areas of consolidation had been determined, the motives given by each of the brands for these deals were explored and summed up. The main reasons determined at this
point for why brands are vertically integrating their supply chains were: because of increasing demands, as a means to guarantee and maintain quality, to preserve traditional skills and know-how, to have control over the whole process of product development and distribution, for the brand prestige, and to aid efficiency and flexibility. However, considering the fact that brand representatives will always answer with a response that reflects positively on the brand, these reasons could not be considered as the absolute truth, and therefore it was necessary to investigate additional benefits that may come from the vertical integration of the supply chain by a luxury brand.

Taking all the findings on possible motives from the previous sectors into consideration, and combining them with theory that explains the benefits of supply chain management, it was possible to determine the main possible benefits that could be incentives for luxury brands to integrate their supply chains. The main benefits that were established were placed into the categories of: product provenance, control of quality and supply, prevention of counterfeit goods, pricing & cost reduction, brand ethos (craftsmanship and heritage), competitive advantage, and economies of scale. Product provenance can be seen as a main benefit because by gaining control of their suppliers, it leads to a higher level of transparency among luxury brands, which could result in higher brand loyalty from customers, because they can be assured of ethical practices and ensured high quality products. Having control of supply and quality is a benefit because brands do not want to run the risk of having to deal with lost profits due to a lack in supply or the quality of goods. Prevention of counterfeit goods was seen as a possible benefit, however it relates more to areas like alcoholic beverages and not so much to the luxury apparel or jewellery sector as goods are too high end. Pricing and cost reduction is a benefit established through having control of the logistical process, where large amounts of money can be saved by efficient practices. Brand ethos can be further enhanced by the purchase of suppliers with a strong historical background or innovative techniques that add to the exclusive offering of a product. Competitive advantage can be gained by creating transparency, reducing costs and therefore creating higher profit margins, by having control over the supply and quality of luxury products, and by strengthening their brand ethos of heritage and craftsmanship. And lastly, economies of scale, the advantage here comes through being able to stabilize costs by producing high volumes, which luxury brands are able to control once they have transparency in the supply chain.

Now that the possible benefits from the previous consolidations by luxury brands have been explored, it is interesting to consider where future consolidations may take place. Therefore, this will be the base for my product which will make use of the insights gained from this research report as a way to determine which areas may be the focus of future investments.
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Interview with Henny Jordaan, supply chain expert at the Amsterdam Fashion Institute.

Q: How does having control over your supply chain influence the success of your business?
A: Supply chain is the most important issue, if you don't have proper control over your supply chain then goods can be too late, transport can be very expensive, things are unreliable. You need to be able to handle big amounts of goods, this can only be done by knowing what is going on in the whole process, you need to be proactive, you need to be in contact with everyone all the time, and documentation can be very complicated. The only way to manage success is to know how the supply chain is operating, if you rely on too many other people you become vulnerable. Your product should be durable, and the process should be structured to work for many years so that you are able to plan for the future.

Q: What would some of the causes be that lead to companies wanting to invest in their supply chain in regards to raw materials, manufacturers?
A: You need to look at the value of everything, if the value of fabric is higher than manufacture. Someone in charge of the supply chain needs to be able to calculate, deal with people both in management and on the work floor, need to know about international trade and customs.

Q: Why would luxury brands focus on investing in certain aspects of their supply chain and not others?
A: In the luxury industry the suppliers and manufacturers know each other very well, they have their own way of negotiating prices, speak the same languages etc, and you don't want to interfere with that infrastructure.

Q: How would having control of your supply chain feed into a brands goal? How would it be tied to the product offering?
A: When you have control over your supply chain you know everything much more up front, which means you can plan better and predict better. Especially when selling to retailers through wholesale, you need to let customers know when things will be available. The timing to get everything right is all logistics, the same as with cooking on programmes like Masterchef, how they are able to get everything done in the time frame. Logistics can help save you a lot of money, for example Zeeman has over a year of lead times for some of its products, so they can use slower modes of transport, save costs for storage in a warehouse. It helps the overall logistical scheme.
Interview with Mario Ortelli, senior research analyst at Sanford C. Bernstein Ltd

Q: What do you think the main causes are of the trend towards vertical integration by luxury brands?
A: Two reasons. Firstly, luxury goods have to be more exclusive in order to meet the clients perception, heritage and craftsmanship are something that consumers value more and more and investing in their supply chain is one way for luxury brands to secure this. Secondly, specific production activity is becoming scarce, and therefore it is very important to try and secure it, like exotic skin for example, there is a bottle neck on the supply. Or in the watch industry where you have to wait weeks to get dials, so you are stuck with inventory.

Q: Why do you think luxury brands are focusing on certain aspects of the supply chain and not others? eg. Leather/shoes but not ready to wear
A: Outsourcing is a matter of complexity. Many suppliers of ready to wear exist in the industry, and production needs to be scalable in order to use certain machinery and meet the volumes. So the brands usually invest in companies with more continuity like embroiderers or exotic skins, or like LVMH who has internalized production of shoes. It is usually really high end companies that they buy into because they control the sources of the values of craftsmanship and innovation.

Q: Do you think the luxury companies will really allow their acquired manufacturers to continue supplying their competitors?
A: Usually luxury brands do not produce enough volumes to stay profitable not supplying other companies. So if it will help your company to be more profitable it is always better to sell to competitors. Swatch will not cut off all supplies to their competitors, they only want to continue supplying certain companies because entry level brands don't invest in building production capabilities in order to gain a successful market share and therefore they don't have the pricing power so if you look at the omega replica it is like they are selling a fake BMW with a real BMW engine. Swatch will always sell to Cartier for example, so they will not cut off the supply, they only want to sell to specific high end brands with the pricing power to support the watch movements.

Q: In what areas do you foresee future integration?
A: The jewellery industry is growing a lot, maybe small jewellery ateliers.
Interview with Franck Delpal, economics teacher at IFM.
fdelpal@ifm-paris.com + 33170388989

Q: What do you think the main causes are of the trend towards vertical integration by luxury brands?
A: It is to support the industrial basis and keep production in Europe. If you look at how they control it, they integrate areas with higher revenue not necessarily related to the core business but rather for better margins. It helps the diversification of the brand, it helps them acquire the know-how, and there is the economic issue to control pricing and distribution, and to produce at an industrial scale. They choose accessories because of the high margins, they like to talk about the ateliers but not the factories but it is actually a very small part however they don't want to say they are industrial.

Q: Do you think the luxury companies will continue allowing their manufacturers to supply their competitors?
A: There is a difference between what a company says and what is true. They want their suppliers and manufacturers to work for their competitors because they need to have the scale. Luxury brands need to support these suppliers. Integration is something that only the big brands are doing but they are controlling the whole process, from manufacture, to raw materials and retail. It is really an issue to be able to produce enough. It is also a way to create barriers to entry to new brands as almost all of the suppliers are controlled by the big brands.

A: In what areas do you foresee future integration?
Q: Leather is a main field of interest and it started with the manufacturers which are now all taken care of. The second step is the raw materials which is almost done as many brands have already invested in tanneries. Now the issue is the animal, so brands are already beginning to talk with the farmers about the best treatment of animals in order to help guarantee the highest quality of skins. So in the future we may see that luxury brands will even have their own farms for exotics like snakes for example. In textiles this is not really worth while. There are 3 kinds of integration: the development of the core business, safety integration to save the know-how, and the development of the brand. Usually they begin by setting up their own manufacturing and then move on to raw materials.