8/ Organization: talents, structure, process and governance

8.1 The organization of Luxury brands… What exactly do we mean?

There are many different "Luxury Maisons". The organizational challenges for huge, powerful "juggernauts" that make several billion euros in turnover as part of listed Groups, on the one hand, and "family treasures" with reputations that may sometimes seem disproportionate to their size, on the other, are quite different.

Managing talents is completely different for complex networks of international organizations and for SME in which it is more a question of "one person - one job".

Let us first look at a few figures as a frame of reference.

8.1.1 A beautiful baby that has grown quite a lot over the years

279,000 employees (source: 2019 annual reports), **this figure represents roughly the entire staff of the five leading players in the Luxury Industry in 2019.**

The majority are at LVMH with 163,309 employees. Kering is second on the podium with nearly 38,000 employees, followed by Richemont (35,640), Chanel (28,000, according to 2019 LinkedIn estimates) and finally Hermès (15,417).

With the exception of Hermès, all of these companies are now conglomerates combining several brands. This is the case with Chanel, which, in addition to the group of *Métiers d'Arts* acquired in the early 2000s, also owns the swimwear brands Eres and Orlebar Brown.

Not even counting our British friends Burberry (9,862) and our Italian friends Prada (13,988) and Armani (7,309).

"x 3.2": take this figure. It is more or less the average increase in staff numbers between 2000 and 2020 at LVMH, Richemont and Hermès.

Staff numbers at LVMH have increased by a factor of 3.19, those at Richemont by a factor of 3.43 and those at Hermès by a factor of 3.32. For employees with more than 15 years' experience at the same Maison, it is easier to understand their feeling of having gone from being a large family SME to a world company.

Over the last 20 years, staff numbers have increased by 3.2 and turnover has increased by 4.9 at the large Luxury players.

The weighted average factor for the increase in turnover has been 4.9 for LVMH, Richemont and Hermès.

This figure is clear, with the productivity of these players indeed having increased, supporting their incredible growth. Turnover has increased by a factor of 4.6 at LVMH, 6.0 at Richemont and finally 5.6 at Hermès.

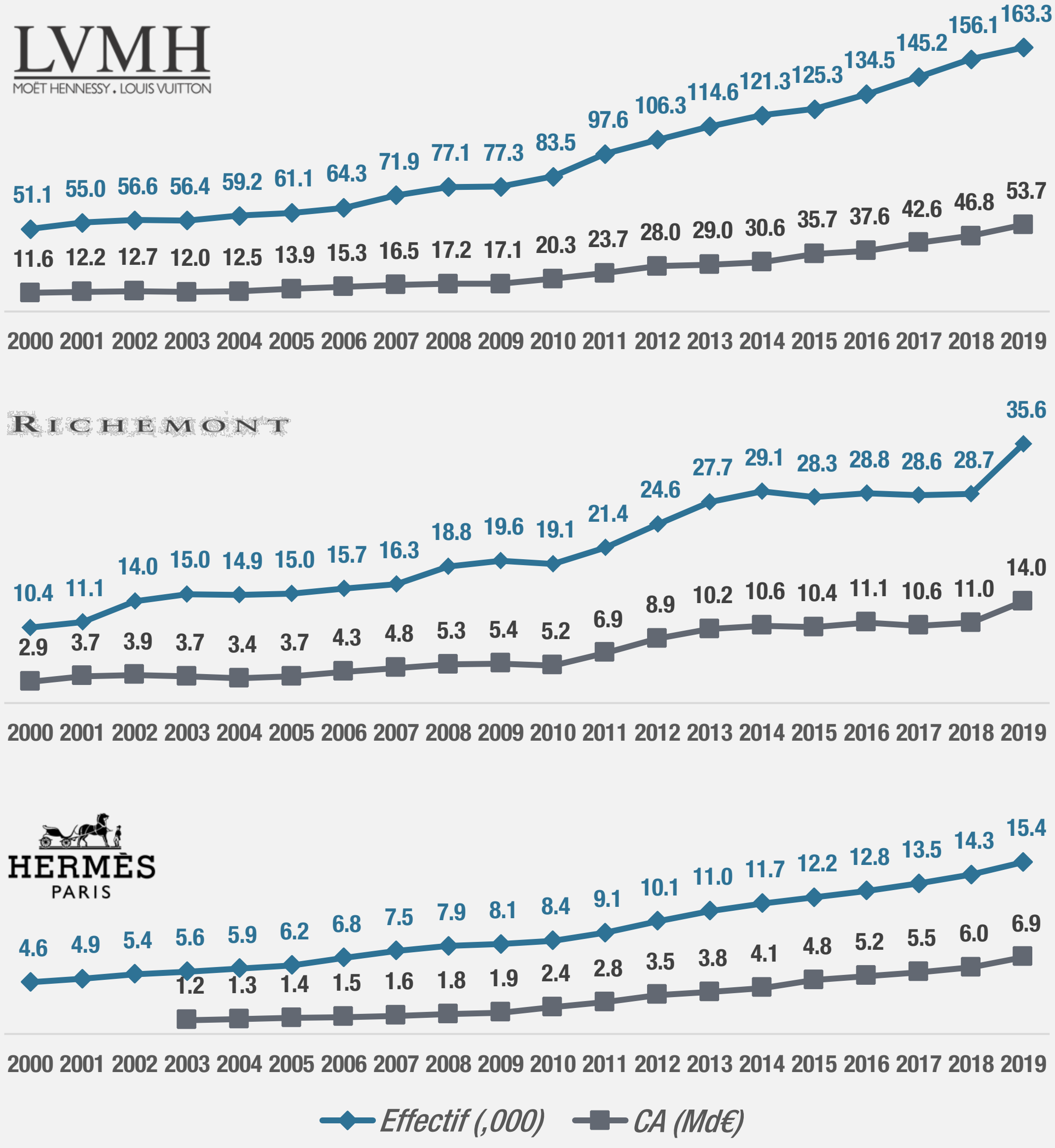
These organizations have grown during the last three periods of growth in the Luxury Industry (2004-2007, 2010-2012 and 2016-2019), driven by the increase in global retail space (in each store and across the retail network as a whole), the growth of Chinese *clientèle* and the diversification of the product categories of some of the largest Maisons (turning them into veritable lifestyle brands).

It is clear that **these last twenty years have presented a major challenge for organizations: processing the growth.**

Organizations and their talents "have followed" and have grown very quickly. Some functions and teams have been created to meet urgent needs, some of which have since disappeared or evolved, without the structure having to be reconfigured as a result. For very good reasons, "evaluation" or "feedback" is not always carried out: when the machine is operating at full tilt, it is often more effective, more profitable and therefore better to focus on keeping your foot to the floor rather than looking in the rear-view mirror to learn lessons from any partial success that is already behind you.

The hiatus imposed by the crisis could be an opportunity to take stock.

GRAPH 8-1
TURNOVER AND STAFF VARIATIONS (2000-2019)



Sources: LVMH / Richemont / Hermès Annual Reports

These last twenty years have presented a major challenge: processing the growth.

From 2000 to 2010, most brands opted for matrix-type organization models, combining expertise functions and direct engagement functions with operations or business. **These choices of organization have been crucial to achieving the extensive period of world expansion**. The much talked-about organizational matrices, decried both for their complexity and for the sluggishness of their decision-making processes, are also formidable machines when it comes to optimizing expertise functions (finance, HR "Human Resources", marketing, retail, *clientèle*, communication, etc.), which the introduction of ERP ("Enterprise Ressource Planning") has accelerated.

The wave of growth has currently subsided for a while. **Will these matrix organizations remain the only answer? Can they be reinvented?**

Matrix organization models have underpinned growth so far. What organizational models will be right for the future?

In the next few chapters, we will look at the short- and medium-term challenges that are undoubtedly going to require changes regarding the choices of organization made in the past.

8.1.2 Stories of families

"We had to explain every move we made and justify every investment, which had to return a profit almost immediately. A long-term investment policy was therefore no longer possible."

This is how, in 2008, Olivier Courtin-Clarins explained his and his brother’s decision to buy back from the market all of the shares in circulation (35% of the capital of Clarins) in order to regain their independence.

Chanel, Audemars Piguet, Patek Philippe and Hermès (most of whose capital is family-owned) are iconic players under family ownership.

The relationship to time varies considerably between listed companies (LVMH, Kering, Richemont, etc.) and private and family companies. However, we should not forget that, even though they are listed, the majority of the equity (or at least of the voting rights) of these large Groups remains in the hands of families. It is therefore wrong to say that Messrs. Arnault, Pinault and Hayek are subject to the same short-term obligations as companies where the majority of the capital is floating.

On the other hand, it is true to say that **being listed requires constant financial communication and this could thus limit the taking of radical decisions**, particularly at a time of crisis.

Independence, and hence a form of strategic freedom, comes at a 'price'. **The long relationship to time and the desire for autonomy in dealings with markets takes cash and impetus** - in short, life assurance against the loss of sovereignty.

In the current period of economic turbulence, the amount of cash you have will determine your ability to maintain a strategy guided by a development rationale rather than by a rationale of financial constraint. In this respect, **defending the level of profitability by reducing non-strategic expenditure will be key**.

The impact on organizations, recruitment and a rationale of restructuring will be considerable in the coming months. Strategies will also vary depending on the profile of the Maison, be it a "powerful juggernaut" or a family-owned SME.

Nevertheless, **everyone will have to implement unprecedented measures to rationalize costs (of distribution) and simplify working processes** discussed in this section of the study.

8.2 Four subjects for the short term, starting 2020

We will concentrate here on subjects of organization which are on the agenda of the majority of Luxury brands: digital, the restructuring of the distribution network in Europe, models for the payment and collaboration of sales teams and, last but not least, the engagement of employees.

8.2.1 The digital function at its turning point: the end of the black box

Long regarded as an "exotic animal" in the organizations of Maisons, the digital function has proven to be a strategic one for both brands and distributors for a number of years already.

As mentioned in previous sections of our study, **the brands that are able to overcome the crisis better than others are the ones that have invested in multi-channel capabilities and which have secured strong ties with their customers** - beyond merely e-commerce, which is ultimately less critical.

During lockdown, brands that ceased operations and did not grow their online presence have lost their relationships with their customers.

They have jeopardized their resilience because they have shown themselves to be incapable of maintaining links with their customers that could now only be digital.

And in this virtual arena, only brands whose products are of clear value and whose DNA is strong stand out from the crowd in an incessant - and sometimes desperate - flow of communication.

Digital transformation affects three main areas: the customer and operations, but also collaborative working methods.

Multi-channel capability in particular has demonstrated, in all sectors – and especially in Beauty - its capacity if not to increase sales, then at least to understand in real time the tastes and expectations of customers. The new methods of consumption that it has generated, such as live streaming in China, are rocketing and present their own organizational challenges as they require marketing, communication, purchasing and a supply chain, with highly concentrated sales 24 hours a day.

In the context of Covid-19, **"Direct-to-Consumer" is proving its worth and, with it, the position of the customer in the organization of the brand**.

Digital is not a function as such. It is the emergence of new technologies in service of a strategy.

At the same time, **the ability of retailers to offer customers memorable and meaningful experiences and to enhance their reputation among a connected community is key to their survival**.

It is not news to announce that matters of digital transformation have never been central to the strategies of many Luxury brands.

But the facts of the matter as far as organization and recruitment are concerned speak for themselves: during this difficult period of staff cuts at most brands, communication and digital development talents are not affected by the crisis and are among the most hunted and recruited heads!

For many Maisons, this function, referred to as "digital", is on everyone's lips but suffers from **black box** syndrome. Nobody should underestimate the current level of misunderstanding of this function among the members of executive committees, it seeming to them like a vague notion, a complicated tool that is overly expensive and has an as yet unproven ROI ("Return On Investment"). This is undoubtedly also the case because they do not know how to approach it. It is sometimes useful to start by raising awareness and clarifying the issues in order to avoid making strange decisions.

Digital is not a function as such. It is the emergence of new technologies and their effective use in the best service of a strategy.

In rather simplistic terms, it is generally accepted that **digital transformation affects three main areas within an organization**:

- The most visible includes all **actions relating to customers** (communication, commerce and the products themselves).
- The hidden part of the iceberg is **the back office**, the operations (logistics, finance, production and information systems of course).
- And, finally, a third dimension which covers all the constituent elements of a **Maison's culture** and includes operations and collaboration models. The switch to remote working, for example, can have a major impact on the internal culture and requires an accompaniment through this transformation.

The MAD Academy has been particularly solicited on these matters since the health crisis. It is a huge area and, as choices have to be made, we will focus today on the brand and the customer.

And as far as the customer is concerned, we must distinguish between **two main tasks**:

- The first will be referred to as **performance business**, which endeavors to support and accelerate sales across all channels.
- The second will be referred to as **branding**, which covers all presentations of a brand to its ecosystem, customers of course, but also (future, present and former) employees and also suppliers; it is expressed in all media, social networks, Apps, training modules, etc.

> **The two main tasks of digital are business and branding.**

These two tasks can be coordinated. But not always. Understanding the issue and the strategy of a brand is therefore key to clearly defining the profile sought and the main tone to be used.

//// Digital, as a tool for orchestrating business

There are two reasons why the digital function has been invited to join the business conversation.

The first is that it allows data to be collected and analyzed. It is a powerful source of inspiration without necessarily bringing into question the predominance of creation over standard marketing approaches.

Although the impact of media campaigns and communication activities in general is sometimes still difficult to quantify precisely, one of the main strengths of digital is its ability to measure (almost) anything based on all of the points of digital contact of a brand or a distributor.

Data revolutionizes knowledge of the customer and therefore, amongst other things, merchandising processes.

In the context of saturated markets and the over-soliciting of customers by brands and retailers, **the analysis of data that has been gathered increasingly reveals customer communities**, purchasing behavior and, in particular, the importance of recommendations in purchase decisions.

This also makes it possible to take a **forward-looking approach, to anticipate trends** or, at the very least, to correct course more quickly if any moves prove unpromising.

The subject of data raises innumerable questions as regards database integration and tools: the introduction of PIM ("Product Information Management") to align all company data, the construction of a Data Lake carefully combining internal and external data and the provision of data science and machine-learning artificial intelligence skills, to mention only the most widespread.

The benefits in terms of business impact are potentially huge. These go from the effectiveness of proprietary site search functions (at Galeries Lafayette, 25% of customers use this function), to understanding the behavior and the digital and physical routes to purchases taken by different profiles of customer, along with increasing sales assistants' knowledge of their customer to enable them to make recommendations that are more effective, even extending to identifying trends (styles, colors, etc.) many months in advance… with the goal of ultra-dynamic merchandising.

As an example, the power of analysis of the data made available to managers at Galeries Lafayette by data scientists in the digital function is, in particular, what has enabled this Department Store's purchasing and commercial policies to develop profoundly over the last few years. Conventional categorical approaches have made way for analysis and therefore decisions based on each customer's profile. So, Millennials are under-consuming Beauty products at Galeries Lafayette? … but Beauty is the category that inspires the greatest loyalty. It is perhaps worth reconsidering the mix of brands referenced? The analysis carried out on the basis of this data has been extremely useful to CRM ("Customer Relationship Management"), purchasing and sales teams.

In an Industry where things move slowly, digital provides speed.

The second reason is speed.

Speed, indeed, immediacy, is the watchword when it comes to digital. There is no longer any delay allowed as regards the digital services and platforms development. More than ever, clienteling platforms have to be effective and operational. More than ever, drive-to-store or remote sales services have to come to the rescue of declining traffic. It is time for widespread mobilization and action needs to be taken quickly, even though **test and learn measures that are often carried out in digital technology run counter to the values of excellence and risk aversion that are so deeply ingrained in the culture of Maisons**.

Action can be taken very quickly in relation to digital transformation and it is untrue that "it's just a question of money". How many times, during lockdown, have we heard that "Covid-19 has made me do in 3 weeks what would have taken me 3 months, and in 3 months what would have taken me 3 years"?

Only the digital function can today create the conditions for this speed by involving all of the energies of the company.

There are three specific levers of digital acceleration: the method, the technological choices and governance.

Digital has **three specific levers of acceleration** to be used:

- **The method**: the weekly deployment of new solutions requiring the adoption of the **leanest and most agile methods of project management** by managers of trades and IT ("Information Technology"). In itself, the method used to carry out the project is a primary area of innovation for brands around which the digital function has to gather all of those involved, from marketing to IT.
- **The technological choices**: brands are not Farfetch! They do not have the means to align several hundreds of full-time developers. In the present context, the managers choosing the application modules **has to look to the "best of breed"** (which is best on the shelf) and avoid any tendency toward specifications or developments that would limit possible upgrades of application versions in the future.

- **Digital governance** which no longer has to orchestrate investment decisions in the vacuum of each function, **but cross-functionally, generally through the prism of customer profiles** that are to be developed. The challenge here is to unclog the portfolio of development projects to focus human, technical and financial resources on current priorities (such as developing clienteling applications and remote sales applications for in-store sales teams).

In terms of organization specifically, the digital function which operates as a business orchestration function may affect over 100 employees and partners in the largest Maisons. To whom is this function attached? IT, retail, communication? All of these options may be considered, but attachment at the highest level is essential.

The balance between "technique and business", inherent in the CDO function, is even more delicate in the world of Luxury.

The Chief Digital Officer’s task is therefore exciting but also hard and risky. This is also probably why the length of time CDOs remain in their jobs is among the shortest among board of directors positions. The digital function is therefore a function which has to be embodied but also supported. Nor should we ignore the cultural dimension or the CDO’s understanding of what is the essence of Luxury, that is to say Creation.

The balance between "technique and business", which is inherent in the CDO function, is even more delicate in the world of Luxury because the creative element and organizations that have historically always paid more attention to the product than to the customer must also be considered.

//// Digital, the primary branding tool

We talk about editorial design and digital creation, about generating narratives, developing experiences, and producing content (photos, films, etc.) across all digital points of contact (social networks, customer applications, seller applications, training applications, websites, e-commerce sites... even physical stores). **Products need to be amplified with all the singularity and emotions that a brand embodies, despite the reduced formats** (a few seconds in view, small screens), in a context of continuous noise.

Products need to be amplified with all the singularity and emotions that a brand embodies, despite reduced formats.

In terms of organization, digital creation may nowadays involve about thirty employees within a company:

- To whom are they attached? The artistic department, communication, marketing?
- How can we be sure that these profiles are being used primarily for creation? So as always to be fair and consistent among all of the other voices.
- In organizational cultures of the Luxury Industry that rely on internalization: where does this balance lie? … There is a constant need to feed on creative new proposals, but also intrinsically to support the culture of the brand in order to be able to interpret and serve creation properly.
- How can subsidiaries and markets best be served under the complex cultural constraints to be overcome while at the same time limiting the risk of veering off course?

Beyond these structural questions, as was recently mentioned to us by Bruno Alazard, CDO at the Maison Kenzo Mode (cf. MAD About Digital broadcasted in June 2020), **this acceleration of digital activities is exacerbating very specific issues of agility and global / local balance**.

This acceleration of digital activities is exacerbating very specific issues of agility and global / local balance.

It is impossible for digital teams in Paris to understand digital in China as well as Chinese teams. What can be done at a global and local level in terms of image, marketing, managing policies for the opening and closing of digital wholesale outlets of partners such as Tmall, JD.com or Secoo, in terms of managing data using the tools of local partners such as WeChatworks (in addition to legacy tools), and managing digital campaigns?

Tmall is a particularly compelling case in terms of managing campaigns. Tmall requires 300 banner formats. Their use is optimized by artificial intelligence to maximize their impact on the public. In this case… what team should take the responsibility for the 300 different formats of the Tmall banners - a web master in China or the Paris team?

It is by ceasing to treat digital like a mysterious black box and being clear about its missions that a strategy can begin to be formulated, a prerequisite for success in a post-Covid-19 world.

The mapping of talents to be recruited internally and the degree of internalization of the function are questions which then become easier to answer when the list of tasks is robust, the strategy is clear and the choices of governance have been made.

Le *mapping* des talents à recruter en interne, et le niveau d'internalisation de la fonction, sont des questions qui se posent ensuite avec plus de clarté, quand la liste des missions est robuste, que la stratégie est claire, et les choix de gouvernance posés.

8.2.2 Restructuring the distribution in Europe: the first response to face the storm

The network of stores of the Luxury Maisons is vast. The reality behind it varies greatly, but the reduction in traffic impacts all stores.

GRAPH 8-2 NUMBER OF POINTS OF SALES WITHIN THE EMEA REGION IN 2019 PER FORMAT, POP-UP STORES & SEASONAL STORES EXCLUDED ALL PRODUCT CATEGORIES COMBINED

SEGMENT	LOUIS VUITTON	GUCCI	DIOR	CHANEL
Concept Store	0	1	0	0
Flagship & Global	13	10	5	8
Free standing	68	44	58	54
Mall / DS / Corner	39	99	17	29
Travel Retail	5	15	3	4
Outlet	0	12	0	0
"Test store"	0	0	3	0
TOTAL	**125 (33%)***	**171 (33%)***	**86 (40%)***	**95 (21%)***

*Percentage of stores within EMEA vs the rest of the world

Sources: Institutional websites, MAD expertise, Brand Experts interviews

- **European flagship stores will be hit hard**: genuine tourist attractions, they owe the covering of their astonishing capital expenditure and especially of their record-breaking rent solely to the flows of tourists… It is necessary to reflect on their role and to rethink part of their operating model to reduce costs as far as possible.
- Although it is unthinkable to close them, a rationalization of the number of flagships is already on the agenda of certain brands in a context where engaging local customers will not make up for the loss of tourist, and especially Chinese, customers.
- **Stores located in secondary cities, already tend to be oriented toward a local clientèle**. These stores will be affected, but may in some cases be a lifeline… So it is not necessarily a question of closing these either, although the issue of optimization will arise there too.
- The question is obviously different for a heavily retail-focused network compared to a heavily wholesale-focused network where the consequences for the Maison differ considerably. Closing a counter does not cause the same trauma as closing the store itself.
- Detailed analysis is already being carried out by numerous players. It combines projections of tourist customer flows by nationality (Asian, Russian, Turkish, Middle Eastern, American, African, Western European, etc.), assumptions regarding the (limited) increase in the recruitment of local *clientèle*, (optimistic) and bets on the improvement of conversion rates and the (probable) scenario of a reduction in the size of the average basket. Few brands will have the luxury of maintaining their current network of stores. **The network needs to be rationalized in order to maintain the balance of the trading accounts of each of the European markets.**
- Against this background of a contracting market, such rationalization decisions will only make sense if they form part of an ambitious plan to maintain the spread of the Maisons' points of sale in Europe: raison d'être, concepts of experience, shop windows, events… **all of the creative and managerial energies of the brands are going to be mobilized to position the most iconic points of sale in the hearts of the customers.**

The reduction in the tourist flow may trigger a structural shortfall of roundly 30% to 40% across Europe and a network restructuring.

The reduction in the flow of tourists and the localization of Chinese purchases in China suggest that there will be a structural shortfall of approximately 30% to 40% for the most resilient brands across the European zone. Mobilizing the local *clientèle* will not be enough to offset the loss of tourist *clientèle*, particularly from China.

The rationalization of the distribution networks, in "technical" terms, is not in itself anything new for Maisons. Sales force rationalization measures in the US and Asia and the construction of regional headquarters have already been carried out in the past following the 2008 crisis or on the back of organizational changes (the regular swing of the pendulum from centralization to regionalization and back). A number of large Maisons have had to rationalize their networks in Hong Kong and Mainland China since 2014.

The unprecedented difficulty, beyond the sheer magnitude of the crisis, is the localization of the problems in Europe, at the very headquarters of the brands, in the stores around the world, within those teams that are flying too close to the sun.

For the vast majority of Maisons, drastic measures have already been taken to reduce the size of the workforce.

Put simply, footfall has declined so extensively that staff cuts are inevitable. What other option is there when, like Gucci, 63% of your customers in Europe are associated with tourists? **For the vast majority of Maisons, drastic measures have already been taken to reduce the size of the workforce**: reducing the number of temporary staff and staff on fixed-term contracts and stopping probation periods, that's been done.

These decisions sometimes require teams of sales assistants not only to deal with customers ("front office"), but also to carry out certain "back office" activities. This only applies to stores with large teams where the distribution of tasks has changed in recent years. In stores where there are just three people in the entire team, this question makes no sense: everyone has been doing everything for a long time.

But let's return to structured flagship stores employing teams sometimes made up of dozens or even hundreds of people. A form of "back to basics" for these sales assistants who act as "runners" (in other words they "run" to find products in the storeroom, sometimes quite a long way away from the shop floor). Sales assistants are also responsible for packaging, make cups of tea that are offered to customers, handle any tax refunds (should there still be any straggling tourists) or a whole panoply of other 'fun' operational tasks at the store, from security to implementing visual merchandising guidelines. Given the speed and duration of the reduction of traffic, **these emergency measures mean that costs can be cut**

The challenge is two-fold: ensuring economic rationalization while improving the customer's in-store experience.

and the jobs of the most qualified staff can be protected, those which the House has taken time to train and who most embody the DNA of the Maison… urgent and sensible decisions.

The fact remains that these urgent decisions, which are necessary to limit damage to this year's P&L ("Profit & Loss"), will not suffice over the medium term. It will be crucial to ensure that CRM and sales management become the priority focus of salespeople again.

For stores where traffic remains high, **the challenge is to increase the conversion rate and the average basket size by focusing the useful time of shop assistants on welcoming customers and managing the ceremony of the sale**. This means that the parameters of this much talked-about ceremony need to be set. We are often surprised, in stores with high traffic, to see the point at which the focus of sales assistants on their customers is distracted by a series of "associated" tasks which, although essential, do not have to be done by sales experts. Do the test in your own points of sale! During a standard day, what proportion of the time do your sales assistants devote to tasks associated with managing customer relations? If it is not more than 70%, it is probably necessary to look at the distribution of tasks in store.

And then, there are stores with low traffic where time seems to pass slowly and is sometimes burdensome for teams. In these stores, how much time do your sales assistants devote to clienteling activities? 30% would be a good target. **This requires an energizing of the entire chain between the store and the headquarters to provide sales assistants with the clienteling tools and information enabling them to mobilize customers**.

> **The small sizes of the teams offers an opportunity for reinvention and a chance to accelerate the overhaul of retail jobs.**

The small sizes of the teams now offers an opportunity for reinvention and a chance to accelerate the overhaul of jobs in the retail sector: a focus on clienteling activities, mobilization of the local *clientèle*, removal of "pain points" in the customer's buying experience, development of the managerial dimension of store managers, strengthening and clarification of the roles of visual merchandising experts in store and at market level, adaptation of payment models to meet new challenges in the development of the customer experience, as will be discussed in the section below.

8.2.3 Remuneration models for salespeople : all hands on deck

Before the crisis, we had already been asked by a number of clients about the appraisal and remuneration models of sales assistants. Today, this question has become a hot topic.

The remuneration of sales assistants is conventionally structured around the following elements:

- **A fixed portion**, which, for the vast majority of brands, varies **between 60% and 75% of the overall pay**, excluding profit-sharing and incentive schemes for Groups or large brands.
- **A variable portion**, which generally represents **between 25% and 40% of the overall pay**. Depending on the culture of the brand and the markets, this variable portion combines, to varying degrees, individual and collective performance criteria. In simple terms, there are two philosophies when it comes to the variable portion: the "Richemont" school and the "LVMH" school:
  - / **The "Richemont" school combines mechanisms for pooling sales at store or market level, redistributing a proportion to each sales assistant, with criteria linked to individual performance**. This model places the greatest emphasis on the transaction amount as the driver of pay compared to other criteria linked to the quality of in-store processes (evaluated through mystery shopping, stock management, ad-hoc projects, etc.) or to the performance of the customer experience (NPS "Net Promoter Score", CRM, customer portfolio development, etc.).
  - / **The LVMH school relies on individual and collective target-setting mechanisms fixed through dialog with managers to achieve annual, quarterly and monthly objectives.** This model may be heavily focused on transactions but also allows the significance of qualitative performance criteria to be balanced when determining the pay of sales assistants.

During the lockdown period and the period of reduction in traffic have led to a reduction in the pay of sales teams by around 25% to 40%.

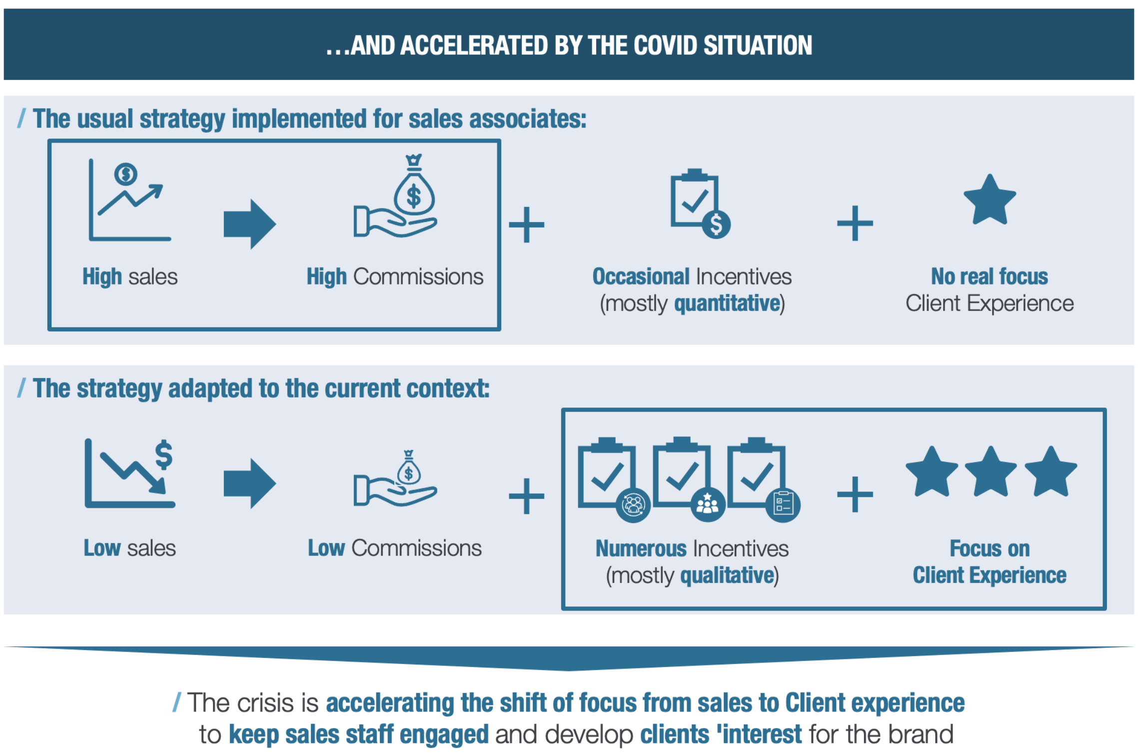
Apart from a few rare exceptions such as the Hermès Maison in Europe where the variable portion linked to individual transactional performance is practically zero, **the lockdown period and the period of reduction in traffic have led to a reduction in pay by around 25% to 40% (the variable portion) for retail populations**.

To deal with individual situations that are inextricably linked to this reduction in their income, many general contract managers have negotiated packages with their head offices to compensate for the loss of their variable portion and keep the income of sales assistants afloat. Easier to justify in China, where a strong recovery was expected after the end of lockdown, than in Europe where the reduction in traffic in store is going to last for several accounting periods… and where a longer-term solution is inevitably going to have to be considered.

Apart from these isolated and rare provisions made by some Maisons that have the necessary financial resources, the reality of the reduction in traffic is accelerating an existing move to reset the balance in payment models. **The significance of criteria linked purely to transactions and more qualitative criteria relating to the development of the customer experience needs to be reconsidered.**

For markets where the challenge is to develop the local *clientèle*, this rebalancing is accelerating all the faster.

The purely transactional criteria and the more qualitative criteria relating to the customer experience need to be reconsidered.



Sources: MAD expertise

The case of a Watchmaking and Jewelry brand recently caught our attention. Right in the middle of a health crisis and in an attempt to maintain the engagement of its teams, the general management decided **to accelerate the switch to a calculation model in which the variable portion is essentially based on the performance of CRM and clienteling activities.**

The pay of teams is a crucial and specific subject that is highly indicative of a Maison's culture. But there is no magic model there either, an alignment with the changing nature of the job of a sales assistant still being required. **How can multichannel capability and online transactions be encouraged if they are not in anybody's interests?** Why invest in the customer experience if only the transaction is taken into consideration? Why should sales assistants want to work in a team if bonuses are individual? How do you reward time spent on a "difficult" category or a strategic product if it needs several months to take off? Well anything is possible if you are consistent…

8.2.4 A pink elephant looms overhead… remote working and, beyond that, engagement

During lockdown, the brands that ceased their business activity and did not cultivate an online presence jeopardized their resilience. They were shown to be incapable of nurturing their customer relationships, which could no longer be anything other than digital.

Group strength within the Maisons is a vital, powerful force: being with others and talking together is particularly important in the Luxury Industry. **It is this group spirit that ensures cohesion between the different business areas and different media (from distribution to communications) and nurtures the teams' creative inventiveness.**

Besides the matter of delicately juggling work and private life, it is fair to say that individual and collective productivity reached new heights in recent months within the Maisons, thanks to remote working and reliance on collaborative work platforms (such as Teams and Zoom).

The marketing teams have never before drawn up so many strategic scenarios in such a short time. The HR managers (those heroes) led from the front in managing the health crisis, understanding and implementing short time working mechanisms, making lockdown exit preparations within the workspaces, leading plans to rationalize workforces, providing support on individual cases, and monitoring the health situation in the workplace. The design studios worked on their future collections and innovated with their work methods through the use of IT tools to design faster and more efficiently and enable the teams to collaborate remotely. These recent weeks have been filled with digital speeches, photos and films produced in Paris, sometimes in several different cities around the world or on the rooftops of the world, in the case of the Saint-Laurent Spring-Summer collection.

All the Maisons reacted to the cancellation of Fashion Weeks by setting up digital showrooms. No more traveling! Buyers are introduced to the collections in bespoke digital environments, guided by avatars (and sales representatives) for a highly strategic purpose: to drive next season's turnover. Balmain's performance, in particular, should be highlighted here, with its showroom attracting a great deal of attention.

Louis Vuitton went still further for its collection by producing a show that was shifted to Shanghai and managed by the local team in China.

The suspension of travel and move to remote working are generating an unprecedented distance for the Luxury Industry. The legendary conventions, where the international lifeblood of the brands all got together in the cradle of their industry, in Paris, Maranello, Rome, etc. have made way for digital events. Many international managers are now wondering about the concept and format of the interactions they want to develop with their local teams in every corner of the world, teams who have never had so much need of support (to guide the growth process in China, for example, and find activation solutions in regard to the local clientele in markets now deserted by tourists). The demand for communication, collaboration and cooperation has never been so great!

These incredible feats, achieved at the height of the crisis, using a work method - remote working - previously unheard of in the Luxury Industry, provide the Maisons with the opportunity to accelerate the transformation of their management methods and team engagement. The MAD Academy provides guidance to the Maisons and retailers on these profound and fascinating matters.

The Covid-19 period has led us to make really rapid progress with remote methods of engagement. The transformations still to come will simply accelerate the voluntary adoption of this approach by the Maisons, who will need to get their teams onboard even more than before.

8.3 Challenges that question the brands' culture fundamentals and organizational models

8.3.1 China / Central : tables have turned

The massive growth of China's domestic market is going to present a real organizational challenge.

We spoke recently to one of the rare Chinese managers of a Luxury brand who told us how much progress still had to be made before homage given by brands to China ceased being a caricature: if it wants to reach an ever more demanding public, a limited edition for the Chinese market will have to go beyond red, gold, stars, dragons or the current year's Chinese zodiac animal.

This challenge in terms of the "product" is just one of many and highlights **the need for the localization of expertise, of jobs, and hence the challenge of recruitment, of cultural diversity and of good governance.**

This organizational challenge calls for a level of agility that no other market has ever required before.

It is certainly not the first time in the history of Luxury brands that a country has pulled away and represented an extremely important part of the business: it brings to mind the US of course, but also Japan in the 90s and early 2000s. But the explosion of the Chinese market is soon going to directly account for nearly 50% of customers in the Luxury Industry - purchases made by the Chinese abroad of course hinging upon the desirability of the brands on the domestic market.

The challenge is an organizational one because it calls for a flawless understanding of the codes, practices, technologies, language and political environment in a uniquely fast-moving context that cannot be achieved through long journeys back and forth between subsidiaries and head offices to approve any steps taken - further constraints that no other market has imposed before.

In a Luxury culture characterized by control, meeting these challenges is no easy feat: what decisions to take at what level, on what subject… while being certain of good mutual understanding.

The marketing director of a large Cosmetics brand belonging to a major international Group told us a few months ago about his feeling of powerlessness regarding requests coming from China. To quote him, "China teams changed the tone, knowing where growth was coming now - either you need to be quicker, more precise, in short… be at their service, or they will go local... That is not possible!".

And it is true that there are not necessarily yet in China local teams that are fully aligned with the requirements of central teams: a detailed understanding of Brand Equity, absolute rigor in the expression of the brand, integrity of the DNA… - it is easy to understand the anxieties at a head office in Paris that is so far away both geographically and culturally.

Although entirely counter-intuitive for the vast majority of brands, the decentralization and delegation of many decisions seem inevitable.

Although entirely counter-intuitive for the vast majority of brands, the decentralization and therefore the delegation of many decisions seem inevitable: product range, presentation and clienteling, communication, retail organization, etc.

Fortunately, there are possible ways forward:

//// Improving the diversity of teams at head office

It is imperative to exchange with Chinese teams in order to better understand them. **For example, it is essential to have Chinese representatives at a head office, as no one would be able to claim they lack cultural understanding.**

The executive committees of HQs in Paris and Milan are conspicuous by their lack of diversity at the highest level - and we all know that rot starts from the top.

Operational teams are beginning to understand the challenge and to recruit people, but generally at levels fairly low down the hierarchy.

Having Chinese representatives at head office and on the executive committee is essential.

The move towards increasing cultural diversity, particularly Asian, at head office level is certainly going to prove to be a strategic one, improving even further the appreciation of the challenges presented by markets and the proximity of head office teams and markets.

The ideal solution - although it is easier said than done - would be to establish a channel for identifying talents in China capable of offering mixed routes between the subsidiary and the head office to improve the flow of communication. Although undoubtedly possible for a market leader whose critical size allows it, or for a Group, this approach is certainly more complex for a small brand - but is no less necessary.

At MAD, we experience this every day. We have six Chinese nationals in our Paris teams (out of a total of fifty people and seven nationalities, but China is by far the most represented nationality at our company after France). For the last 4 years we have had a Chinese partner in our consultancy practice.

It is a bit of a cliché to say that we are enriched by this diversity every day, and it is obvious to add that diversity at the coffee machine or at team drinks is not decreed. You need to go beyond simply having a diverse pool of employees if you want to achieve real inter-cultural communication - and this means giving them genuine responsibilities and treating them not so much as experts (tempting as it may be) but as fully-fledged contributors.

How can the control of the product and communication be guaranteed when decisions are taken locally and delegated?

//// Red Zone vs Blue Zones

If we consider that, to ensure consistency, the cornerstone of the Luxury Industry is control, how can this be guaranteed when decisions are taken locally and hence delegated?

Maisons such as Hermès and Chanel have based their growth over the last twenty years on a model finely orchestrating the dialog between different leaderships: head office leaderships (design, corporate communication, production) and local leaderships (distribution, range, customer and clienteling).

But the boundaries are shifting and nowadays China is leading the challenge when it comes to communication, online presence and soon perhaps the product.

In an attempt to meet these new challenges, it is first worth carrying out, right at the outset, a fully structured process of reflection on the whole value chain of each of the roles concerned and identifying what decisions can be taken at what level and with what degree of discretion.

The "Red Zone vs Blue Zones" reflection process is a valuable tool in terms of understanding and deciding how to distribute roles.

The balance of responsibilities between the central and local levels has to be rigorously addressed and understood.

The "Red Zone" includes all central areas of responsibility. "Blue Zones" include all local areas of responsibility. Formalizing these requires a great deal of collaborative work by HQ and the regions to ensure that all subjects have been covered, that a good balance has been struck and that both operational and strategic constraints have been met.

This exercise, a complex one to implement and structure with the necessary rigor, is certainly one of the most urgent areas of development to be finalized with the Chinese subsidiary in order to ensure the brand's ability to address local issues in line with global strategies.

But with responsibility and rights generally come obligations. And although it is often necessary to outline prerogatives that have been identified as local, it is also necessary to specify and communicate to centralized teams what markets need to operate effectively.

Beyond China, or rather in its wake, the crisis will certainly reignite the eternal debate over the roles of regions and countries, and there will certainly not be a perfect solution. **Depending on its culture and its own particular challenges, its size, its sector** - Perfumes and Cosmetics or Watchmaking certainly do not face the same challenges - **each Maison will have to reflect on this fine balance, but with one unusual constraint: optimizing the use of resources**, a new challenge resulting from a rarely experienced economic pressure.

8.3.2 Organizational models: nice engines built for growth

When the Luxury Industry anticipates a 20% to 30% reduction in 2020… it is certain that a **substantial amount of work has to be done to reduce the fixed costs of organizations sustainably by around 15% to 20%** according to our estimates (cf. Part 1 of the study, which details the cost structure of Maisons and possible levers that can be used).

After the booming years of rapid growth (2004-2007, 2010-2012 and 2016-2020), Luxury Maisons have become strong, healthy companies preferring to internalize talents. A superficial reading of the situation might give one the feeling that there is "fat" in the organization of large Maisons (it is less true for small Maisons which are generally far more "down to the bone", as is often the case in SMEs).

It would be quite good news if it was merely a question of starting a weight-loss regime.

The organizational model is geared toward growth and is unprepared for operation modes based on efficiency & rationalization.

But the reality is quite different, for two reasons.

The first is that the philosophy underlying the organizational model means that it is geared toward growth and is unprepared for modes of operation based on rationalization. For over 15 years, the organizations of large Maisons have been like the sails on boats, all stretched tight by the wind of growth with resources dedicated to conquering new audiences, developing new categories of products. **Organizations** where the management of the complexity and of the size of the organization has been taken by cross-disciplinary functions with increasing levels of expertise: customer, digital, operations, transformation….

These teams rely on methods of operation that focus on investment, allow time and resources for innovating and testing, and (sometimes) offer space for adversarial debate (15-stage Brownian validation circuits being a prime example of this). All of these powerful rationales for work (which are what have made the brands what they are today) are incompatible with emergency rationalization and efficiency. It is for this same reason that, at Gucci, during the periods of double-digit growth, the very principle of a budgetary cycle and its "rigidity" was considered "limiting" because it did not fit its ambition to conquer the market.

The organization of Maisons is a highly precise mechanism to be rationalized without being "broken".

The second reason is that the organization of Maisons is a highly precise mechanism, an asset crucial to their value. An asset that is going to need to be rationalized without breaking the "machine".

The panoply of indicators used by financial analysts is still unable to give a very clear assessment of the value of organizations. We hear analysts lament the fact quite often. But, given the culture of secrecy prevalent in brands, it is not easy to see how Maisons really function! Then again, although the literature is full of numerous scientific comments on organizational models and their value … the subject has only ever been tackled superficially as far as the Luxury Industry is concerned: The sector is all about know-how nowadays. It is only possible in Europe! Design lies at its heart!... clichés stand strong…

Why so many non-European companies found it so hard to get established in the luxury business? These companies have the capital. They call upon the same European partners and subcontractors to design products according to European quality standards. New areas of expertise and excellence are emerging thanks to visionary craftspeople all over the world. Countries like India and Japan have always had thousands of them with the Midas touch…

Behind the fantasy of the Maisons, it is the specific organizational nature of the Luxury Industry that prevails and that most non-European companies manage neither to reproduce nor to adapt. This is why more and more companies around the world ask for our help with these organizational challenges to establish themselves as Luxury Maisons.

All experts in the Luxury Industry are drawn to control, with **all stakeholders sharing the same priority: controlling the design, the product and all of its narrative and experiential developments** up to the physical and digital point of sale… indeed throughout the life cycle of the product including the new territory of second-hand goods that is opening up to brands. With their sword-wielding arms of control outstretched, infantry generals around the world are meticulously enforcing the strategic guidelines defined by the HQ.

The exercise of control is highly structured. The significance of markets in strategic decisions may vary depending on the balance of power. At Hermès and Chanel, the weight of central services is major. On the other hand, this power is counterbalanced by the experience of the markets and their knowledge of their customers. As an example, within these two brands, a highly elaborate process of global / local orchestration allows store managers, in particular, to decide what to buy: they are responsible for selecting the products that they will then have to sell.

In other Maisons such as Louis Vuitton, responsibility for product ranges is far more centralized, even though this only works because feedback from the field is provided very quickly and is given due consideration.

There is therefore no one single tried and tested organizational model. Some Maisons have more "top down" cultures, others more consensual ones, but the majority have adopted a matrix vision.

A characteristic common to all Maisons is their indisputably centralized control of the product design and its expression.

A characteristic common to all of them is their indisputably centralized control of the design (product) and its expression (communication).

This feature, so characteristic of organizations in the Luxury Industry, has interesting parallels with industries that are referred to as high-reliability industries such as the nuclear, space and aviation industries. In these companies, control is a mantra that crystallizes around processes, models of governance and talent selection criteria. As in the Luxury Industry, there is no margin for error, or very little margin, less than 10^{-7}. If this were not the case, nobody would ever board an aircraft again and the nuclear industry would have hit the buffers 75 years ago.

Nevertheless, there are still some major differences and they are not insignificant. High-reliability industries are the territory of the engineer where the culture of writing things down is firmly established. Processes are documented, demonstrated and verified.

The Luxury Industry, on the other hand, is often an island of creative minds with all their different forms of expression (product, storytelling, design, illustration, etc.) where dialog is mostly founded on a visual and of the spoken word culture (even though, over the last twenty years or so, Maisons have gone looking for reinforcements in schools of engineering to process their growth. The École Polytechnique is still well represented at LVMH).

The Luxury Sector can learn from high reliability industries to rationalize without "breaking the machine".

Why comparing the Luxury Industry with high-reliability industries in the present context?

We think **the Luxury Industry can learn from and be inspired by these industries to rationalize without "breaking the machine"**. These industries have been there and done it.

The case of Air France is very informative. On June 1st, 2009, the crash of flight AF 447 killed 228 people. It sent shockwaves through the company and exacerbated corporate tensions that had been growing between pilots and other personnel at the company. The causes of the crash were evidently numerous and very complex. But **the accident was in part the direct consequence of decisions to rationalize the organization following the downturn in the economy**. Air France was a flagship of the global aeronautical industry during the 20th century. In this very exclusive club, people said (that is to say, especially in France) that the pilots at the company had taught birds to fly. Experts around the world, including MIT, regularly came to Roissy to learn from Air France. Without going into the details, economic difficulties led Air France to loosen its control (shortening decision-making procedures, limiting the consideration given to the opinions of experts / pilots in decisions, losing touch with the meaning of the business, etc.).

Following the crash, the company underwent a long program of cultural and organizational transformation which raised safety performance to the highest industry standards once again while allowing a nearly 25% rationalization of its operating costs… like NASA, which went through the same trauma twenty years earlier with the explosion of the space shuttle Challenger and underwent its own program of transformation.

In short, **these programs were highly collaborative and an extremely unifying forces as far as the teams were concerned**. They consisted in reinventing key business processes based on two simple overarching principles: **a return to essential priorities** (back to basics / simplification) **and a new dialog and orchestration of roles between experts at head office and experts in the field** in various areas (management of feedback, development of business tools, educational choices, digitalization of business processes, etc.). These two principles seem to us to be particularly inspiring for the transformation of organizations in the Luxury Industry.

This approach goes further than the defining of Red zone and Blue zones mentioned above because it is the whole method of governance that is under scrutiny, beyond the relationship that head offices will have to define with the regional branches, and especially China.

8.4 Let's consider a new perspective… When it is no longer a matter of fixing, but truly reinventing, or even joining forces

The Watchmaking industry is one of the most affected in the Luxury Sector.

Shortly after the climax of the health crisis, both the Richemont group and Swatch group were in the spotlight in regard to their governance and management. The randomness of current affairs? **This Industry is one of the most seriously affected in the Luxury business.** Some Maisons were already experiencing (relative) difficulties before the crisis. As we have now said several times, and it is our firm belief, the Luxury Industry is, more than anything else, a creative industry. This creativity sometimes appears to have been a little extinguished in this category.

We will never be able to stand in judgment over the technical prowess of grand complications or the unrivaled expertise of the craftspeople of the Vallée de Joux.

However, during the crisis, and despite listening carefully, we have not heard much from these Maisons. We haven't seen them "play their part". Patrick Ropert, an expert in crisis management (a Partner at Tilder) told us at the end of March: "people will remember who spoke up during this period". And we will indeed remember Armani, Gucci, LVMH, Chanel and Hermès. A commercial ploy or genuine solidarity? The point here is not to make moral judgments, but simply to say that **we have not heard (much) from Watchmaking Maisons**.

We analyzed the post-Covid-19 consequences for **the Watchmaking and Jewelry market** in great detail in Part 3 of the study. We will not go over them again here. But we thought it necessary, for the following reasons, to underline the **challenges faced in terms of the cultural and organizational changes required** in this Industry:

- **Products have ultimately not changed very much over the last few years**. Usage of high-end products has not been reviewed, nor have functionalities very much because smart watches do not fall within this range segment, and the main players are the same.
- Besides, **the profoundly timeless nature of the product (the very embodiment of passing on) reinforces this feeling of inertia** as it is no guarantee of an unbridled pace of change. The relationship to time is unique. And long.
- **The customer culture is not a cultural reality** as it might be in more "commercially focused" or historically more "retailized" Maisons that are therefore more exposed to the famous end customer.
- **The advanced age of the directors and executives in general in the sector is astonishing**. You fall into Watchmaking when you are very young and, with little external influence, you make your career there.
- **It is one of the sectors of the Luxury Industry most severely affected by the crisis** (the consequences of the above points?).

Let's not conflate things or make assumptions. We have had the opportunity to work with numerous Watchmaking Maisons and we have come across the most committed people there, people who are rightly proud of their expertise and have an insatiable curiosity for the world.

It is also a sector of the Luxury Industry containing magnificent independent Maisons in rude health (Audemars Piguet, Patek Philippe and others). Nevertheless, from our point of view, **if there is one sector where profound change is required, it is this one**.

This study is not the place to reveal secrets or make dangerous predictions about mergers.

However, this will be one of the "classic" consequences of a crisis where the forces of Darwinism are rarely denied. The weakest are gobbled up.

When you listen to financial analysts talking about the Luxury Industry, their message is clear: **conglomerates or Groups** (LVMH and Kering to mention only the largest) **perform better over the long term than listed but more isolated brands** (Burberry, Hugo Boss, etc.). **Nevertheless, independent Maisons** (that is to say unlisted ones like Chanel, for example) **that have reached a critical size** (compared to family-owned players that have seen more modest expansion) **have this beneficial relationship to time that enables them to implement more robust strategies which the short termism of the stock market does not permit**.

Does this mean that the big players in the Luxury Industry are going to be able to get their hands on the weaker ones? Perhaps.

In any case, it is likely that nothing major will happen in the current context, at least in the short term:

- **For potential sellers, 2020 will be bad for everyone**. The valuations of Maisons, multiples of EBITDA ("Earnings Before Interest, Taxes, Depreciation, and Amortization"), are going to sink: not the best time to sell…
- **For potential buyers**, essentially listed Groups, the situation is not straightforward either. **They will first have to reassure investors of their ability to overcome the crisis before taking on any acquisition.**

On the other hand, as soon as brands resume their previous trajectories, it is likely that the scars left by the Covid-19 will end up persuading players of the benefit of joining forces.

Will the Qataris Mayhoola for Investments (Valentino, Balmain, Missoni) attempt any new acquisitions? Will Chinese such as Fosun, whose expansionist strategy is nothing new, be slowed by ventures which are struggling to take off (Lanvin or Wolford that are slow to get their heads above water because this takes time in the Luxury Industry)? And Capri Holdings? Tapestry? The Shandong Ruyi Group?

We'll need to wait patiently for the highly likely reconstruction of the landscape.

Other than for a few brands which may stumble in the short term (and unfortunately, we can already see this coming), **we'll need to wait patiently for the highly likely reconstruction of the landscape**.

For a transfer market in 2020 and 2021?

The sailing metaphor is useful in this context. The crisis is like a mixture of a period of calm weather (when the wind suddenly falls at sea, boats no longer move, you lie idle, and for how long?), and a squall (where you can clearly see the tornado that you need to get past). Calm or storm, these are unprecedented times. And when you need to lighten the boat, it is also a good time to do some housekeeping.

The crisis also provides the opportunity to make some changes at the top.

It may even perhaps be a good thing.

Let’s not forget that managing a turnaround, crisis or transformation is a job where experience matters. A person may be an excellent CEO, CFO or CDO during a period of steady growth but feel less at ease when there is a contraction in business activity.

The Luxury Industry will pick up again, and strongly too. So, it is not necessarily appropriate to perform a complete reset of management profiles to arm yourself with an executive committee filled with crisis management specialists.

When a business is at cruising speed, carried along by great growth and fabulous conditions, making a mistake is less serious (and can even be useful sometimes!). By contrast, when the company is facing an exceptional situation, experience is invaluable. In these sometimes-stressful periods, working with “someone who’s already done it”, or someone able to anticipate the risks, capable of onboarding an organization or addressing a fundamental technical issue, is of vital importance.

Using transition management is now a real option.

At the beginning of March 2020, at MAD, we launched a new practice, transition management (**MAD Experts**). **We are convinced that experience and its proper use will make the difference in getting teams back on track in the weeks to come.**

These Expert managers are in a different position. They have a specific mission to accomplish. They have freedom of speech and freedom of judgment that can be invaluable. No political agenda, just an undeniable legitimacy. Their expertise applies to digital, to distribution in China (or elsewhere), to the post of GM ("General Manager"), HR or any transformation project.

So, when the transfer market has begun and at a time of such uncertainty, let’s not forget ad hoc options!