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SBMA7103 – Strategic Management

Case study of ESPRIT business strategies



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Executive Summary

Esprit a fashion and lifestyle brand founded in 1968 in San Francisco, California and its potential to become the leader in the European fashion industry is examined beginning with general industry-related approaches and ending in a detailed competitor analysis. Esprit's business experience has been ups and downs, and it has become a success in Europe and the United States. It was listed in Hong Kong in 1993. In 2007, the company's market value was 17.15 billion. From 2010, the business began to slip and the stock price fell. The company changed CEO several times and at the same time, different market strategies and reforms have been implemented, but it seems that they cannot change the fate of the company, in 2019, its market price is only 30 billion left.

The reason of failure may be because of the market vision and clothing taste of Esprit's operators is unchanged in the past 30 years with same the image. As the competition in the fashion market is getting bigger and bigger, there are many new competitors such as Zara and H&M in the market. Their business methods are completely different from those of Esprit. If Esprit still adheres to the previous economic methods, it will only accelerate the company's demise.

In this case study, I am going to analyse the previous as well as current corporate/ business strategies of Esprit and find out the critical issues of the company that made its failure. Then, finally to conclude and provide recommendations to the company for improvement.

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1. Company background

Esprit is a listed company in Hong Kong, Germany and the United States that found by Susie Russell and Douglas Tompkins in 1964. The main business is design, procurement, manufacturing, wholesale and retail "ESPRIT" brand men's and women's fashion, shoes, accessories, bed and household items, also has the cosmetics brand "Red Earth". "ESPRIT" was very popular in the 1980s. In its heyday, it is one of the most sought-after internationally renowned apparel brands for many young people.

In 1971, Hong Kong businessman Michael Ying Lee Yuen joined. Established a production and distribution network based in Hong Kong and Germany in the late 1970s. Since then it has become an internationally accepted brand until late 1990's when they slowly drifted low in the market that customers no longer prefer their brand like the way it was. In 1989, Susie and Tompkins divorced and he sold the shares in 1990. Subsequently, Esprit Far East Group purchased the remaining shared and formed Esprit Holdings Limited in Hong Kong. In order to further expand the market in

different categories, Esprit opened its first cosmetic store “Red Earth” in 1991 and “Salon Esprit” in 1999 respectively.

On December 9, 1993, Esprit Holdings Limited “Esprit” was listed on the Hong Kong Stock Exchange with an offer price of \$3.7. In December 1998, it was listed on the London Stock Exchange. In 2007, Hong Kong's turnover reached 728 million, and its share price rose to HK\$123.5, with a market value of HK\$171.5 billion. On December 17, 2009, Esprit acquired the remaining 51% interest in the Chinese joint venture Tactical Solutions Incorporated (TSI) from China Resources Enterprise for HK\$3.88 billion who is the exclusive seller of "Esprit" and "Red Earth" trademark products in China. As of the end of June 2009, it operated 1,112 stores in 171 cities across mainland China, including 345 self-operated stores and 767 franchise stores. The joint venture company's turnover in 2008 was HK\$25.78 billion, and the net profit after tax was HK\$3.62 billion. In the first half of 2009, the turnover was HK\$12.63 billion and the net profit after tax was HK\$1.1 billion. Upon completion of the transaction, Esprit will wholly own the sales rights of “Esprit” and “Red Earth” in mainland China.

In 2010, Michael Yuen sold all the shares of Esprit and then the stock price has been keep falling. In the following 2 years, its business was not good, although the revenue increased by 0.1% to HK\$337.6 billion, but the profit decreased by 98% year-on-year to only 79 million, resulting in a 19% drop in share price. The stock price fell more than 90% from the historical high price and the market value is only about

HK\$100 billion. In June 2018, Jose Manuel Martínez Gutiérrez stepped down from the group's Chief Executive Officer and replaced by Anders Kristiansen, former Chief Executive of British fashion brand New Look. In November of the same year, the restructuring plan was announced. It plans to cut nearly 40% of non-frontline employees and accelerate the closure of loss-making stores in Europe and Asia. It is hoped that the annual expenditure will be saved by HK\$20 billion in the 2019/20 fiscal year.

2. Industry analysis

2.1 Macro and Micro Environmental Factors

Macro

Normally it is including four key factors which are Technology, Demographic, Economic and Political/ Legal.

- Technology has dramatically changed the way business is done in this century. It has changed the way we shop in the past. Now, more and more customers are shopping online. IT has changed the expectations of its customers, and each of them wants to get the service in the best possible way. However, technology has also helped brands in other areas. From supply chain to production and marketing, ubiquitous technology brings agility and effectiveness, which increases productivity. However, this also exacerbates competition because brands compete with each other to have

first-class technology. Any brand must use the best technology to stay competitive. In a sense, technology has become indispensable. From the website to the application, even a better production system, it is vital to stay profitable and retain customers.

- Demographic trends also have a profound impact on the sales and profitability of fashion brands. The demographic structure has changed a lot, and millennials have become an important part of the fashion brand's target market. Their preferences are very different from those of previous generations. They like fast fashion and mostly shop online. They are more tech savvy than previous generations, and everyone wants to get services in a customized way. A large proportion of the population is aging, and the needs of the aging population are different from those of the general population. Therefore, all these factors have brought new demands and new pressures. In addition to demographic trends, fashion trends are constantly changing.
- Economic fluctuations in the global environment may lead to an increase or decrease in the sales of ready-to-wear garments. For fashion brands, the economic downturn is particularly difficult. It is for this reason that people are trying to cut costs, thereby reducing the sales of fashion goods. If the economy is in good economic condition and the level of employment is high, people there will have enough disposable income to buy fashion and luxury goods. This brings better sales and higher profits to fashion brands. However,

this century has fallen into recession, and some countries in the world are still trying to bring their economy back to normal. Not only that, exchange rate fluctuations and a stronger dollar will also lead to corporate profit losses.

- In the 21st century, political and legal factors have become more important in business. There are several laws affecting fashion brands, from laws related to labour rights to environmental laws related to businesses and country-specific laws. Trade agreements also have a major impact on the business of international fashion brands. Import and export related laws will affect the growth and profitability of fashion brands.

Micro

The micro-environment of marketing includes all the micro factors that influence business strategy, decision making and performance.

- The targeted customers are customers are aged between 25 to 35 white-collar with certain economic strength. Customers are a core part of any business because they tend to attract and retain most customers to generate revenue. Therefore, organizations must adopt a marketing strategy that attracts potential customers and retains existing customers by considering customer needs and needs, as well as providing after-sales services and value-added services.

- The competitors of the organization may have a direct impact on the business strategy. The rise of Fast Fashion is also the main reason that cause of ESPRIT's decline. For example, Zara and H&M, regardless of the product quality but only from the perspective of production, sales and management, both Zara and H&M also have efficient management and decision-making links. Even if there are plagiarized, it cannot be denied that the design keeps up with the rhythm of fashion trends. But for ESPRIT, from retail to wholesale, design to launch, also uses a more traditional ways as an indicator. When other competitors can finish the whole design and production in two weeks, Esprit has to spend more than double the time. Moreover, there is no attraction in design and price, so that's the reason why it declines and gradually losing its competitiveness.
- Employees or the workforce is one of the most important factors in the company's production. Human resources are an important factor in a company's success (or failure). Therefore, it is important to hire the right person for your company. The training and development of these employees is also crucial.
- Shareholders invest in the company, but not just investors. They own the shares of the company, so in a sense they are actually the owners of the company. In order to maintain its interest, dividends must also be paid. Therefore, companies must find the right balance between the health of the company and the interests of shareholders.

- The supplier provides the company with the materials and production factors needed to do business. The relationship between the company and the supplier is a power equation. Both of them rely on each other to survive.
- Every company will need the media to promote their brands and products. Therefore, companies must maintain their relationship with the media and the status quo.

2.2 SWOT Analysis

- Strength

Although they have become weak in the market, they have established international recognition. Their strength lies in their experience and ability to produce new styles. They can use the power of the media to regain their strength in the market. They also established multiple networks and contacts in product distribution. They can even come up with new product lines that are acceptable based on their strong brand positioning and visibility in more than 40 countries.

- Weaknesses

Their weakness shows that they have not introduced a new product line during their peak years in 1968 until the 80's, they have settled on their designs and style that people look for new fashion and models of products. R&D has become their weakness, although during this time they have gained good customer trust and the owners themselves did not give customers the

demand. They have become confident that they have stopped promoting and advertising in the media, and at that time, other brands have surpassed them.

This has led to the closure of most of its brands.

➤ Opportunities

There are still opportunities; if they decide to close most of the retail stores in other regions, then in fact they can still be accepted by other countries. In the United States, Esprit has suffered continuous losses in the past few years, but they can take advantage of other countries with long-term restricted distribution, and on their websites, they still have good market demand and a good distribution network. Esprit can also focus on countries that are widely recognized in the UK and Australia.

➤ Threats

As mentioned in 2.1, recent competitors are very strong especially fast fashion brands. Design up to trend with low price and production speed that Esprit cannot provide until now. Another threat is the rapid development of the second-hand goods business which is very cheap and the trust people have in their brands seems to be a threat. In this case, they must build and create new products, quality products, the latest fashion products and low-priced products that customers need.

2.3 IFE and EFE Matrix

Internal Factors Evaluation (IFE)

Key Internal Factors	Weight	Rating	Weighted Score
Strengths			
Global Outreach	0.12	3	0.36
Strategic Location	0.09	3	0.27
Store Image	0.12	4	0.48
Responsive Employees	0.07	3	0.21
Brand Image	0.15	3	0.45
Weaknesses			
Price	0.12	1	0.12
Brand image closely tagged to competitors	0.12	1	0.12
Fast Changing collection	0.09	1	0.09
Lack of Marketing	0.12	2	0.24
Total	1		2.34

➤ Global Outreach

Currently, Esprit has approximately 500 directly managed retail stores and more than 5,000 points of products sold in more than 40 countries. This is strength of Esprit, because Esprit is an international brand company, especially in the apparel industry, Esprit should be global. Therefore, for this factor, a weight of 0.12 is sufficient. We rank this strength at 3 out of 4 because we believe this factor is definitely one of Esprit's strengths, even if it is not their main strength.

➤ Strategic Location

Considering the importance of facilitating industry users, I gave this factor of 0.09. If consumers can find quality products at their favourite shopping

locations, consumers will like it. Since Esprit's geographic location is strategically global, we rated it as 3.

➤ Store Image

Customer loyalty is critical in a highly competitive industry. Therefore, we give a high weight of 0.12 and a ranking of 3, because this strength is the highly recognized company foundation of Esprit.

➤ Responsive Employees

The presence of employees in the store is important for controlling, rearranging items and providing information to customers. As a result, Esprit is also concerned about the responsiveness of its employees, especially because they claim direct communication is their marketing strategy. Consequently, a weight of 0.07 is given for this strength, as it is relatively not important as the other strengths. In term of Esprit's effectiveness in responding to this factor, a rank 3 out of 4 is adequate.

➤ Brand Image

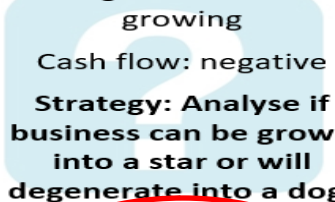
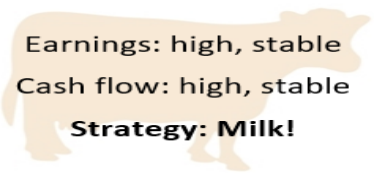
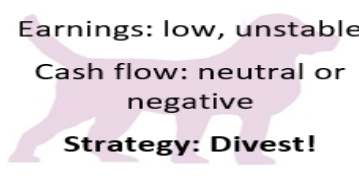
We set the brand image to a maximum weight of 0.15. We do believe that this is the backbone of every participant in the apparel industry and should reconsider again the degree of competition in the industry. This symbolic brand benefit does exist and is important. The brand is known for its unique products and classic products, and its strong brand image has been recognized worldwide.

External Factors Evaluation (EFE)

KEY EXTERNAL FACTORS	Weights	Rating	Weighted Score
OPPORTUNITIES			
Increasing middle class in Asia	0.19	2	0.38
Mobile platforms and payments	0.15	3	0.45
Expand portfolio internationally	0.11	3	0.33
Lower effective tax rate	0.08	2	0.16
THREATS			
Fierce Competition	0.20	2	0.4
Fast fashion environment	0.12	1	0.12
Current economic downturn	0.09	2	0.18
Increasing age of population	0.06	2	0.12
TOTAL	1		2.14

Based on External Factor Evaluation Analysis, Esprit achieved 2.14 for which shows that the company is just above the average for the opportunities and threats in its industries. As a matter of fact, we can see that the performance of Esprit external strategies can be accepted and satisfied. At the same time Esprit needs to reduce the threats since there are more and more competitors entered and involved in the industry.

2.4 BCG Matrix

		RELATIVE MARKET SHARE	
		1.0 High	Low 0.0
MARKET GROWTH RATE (%)	High +20 %	 Earnings: high, stable, growing Cash flow: neutral Strategy: Invest for growth!	 Earnings: low, unstable, growing Cash flow: negative Strategy: Analyse if business can be grown into a star or will degenerate into a dog!
	Low -20 %	 Earnings: high, stable Cash flow: high, stable Strategy: Milk!	 Earnings: low, unstable Cash flow: neutral or negative Strategy: Divest!

The BCG Matrix is a framework created by the Boston Consulting Group to assess the strategic position and potential of a commercial brand portfolio. The business portfolio is divided into four categories based on industry attractiveness (the industry's growth rate) and competitive position (relative market share). These two dimensions reveal the potential profitability of the business portfolio in terms of the cash required to support the unit and the resulting cash. The general purpose of the analysis is to help understand which brands the company should invest in and which brands should be divested.

Basically there are four categories:

➤ Star

A business unit or product that has the best market share and generates the most cash is considered a star. Monopolies and products that are first placed on the market are often referred to as stars. However, due to the high growth rate of stars, they consume a lot of cash. This usually results in the same amount of money flowing in. If the stars continue to succeed until the market growth rate declines, they will eventually become a cash cow. It is recommended that the company invest in stars.

➤ Cash Cow

Cash cow is the market leader, generating more cash than it consumes. These are business units or products that have a high market share but have a low growth prospect. According to NetMBA, cash cow provides the cash needed to turn question marks into market leaders, paying the company's

administrative costs, funding research and development, repaying corporate debt, and paying dividends to shareholders. Companies are advised to invest in cash cows to maintain current productivity levels or to passively “squeeze” gains.

➤ Dogs

Dogs or products or products sometimes referred to as pets that have both low market share and low growth rates. They often break even, not making money or consuming large amounts of cash. Dogs are often considered a cash trap because companies are tied to money even if the company does not bring back any returns. These business units are the main candidates for divestiture.

➤ Question mark

These parts of the business have high growth prospects but a low market share. They consume a lot of cash, but they bring very little return. Finally, the question mark (also known as the child in question) lost money. However, due to the rapid development of these business units, they have the potential to become stars. If the product has growth potential, it is recommended that the company invest in the question mark, otherwise, the product will be sold.

Esprit is defined as Question Mark because its future is not entirely certain. The company must consider investing more in marketing and try to put more effort in Asian market. Its German market is relatively mature and stable, however, Esprit

still not yet successfully break into Asia especially China market. Although there are more than 100 stores located in China different cities, the revenue earned from China was about 10-16% of total revenue in the past years.

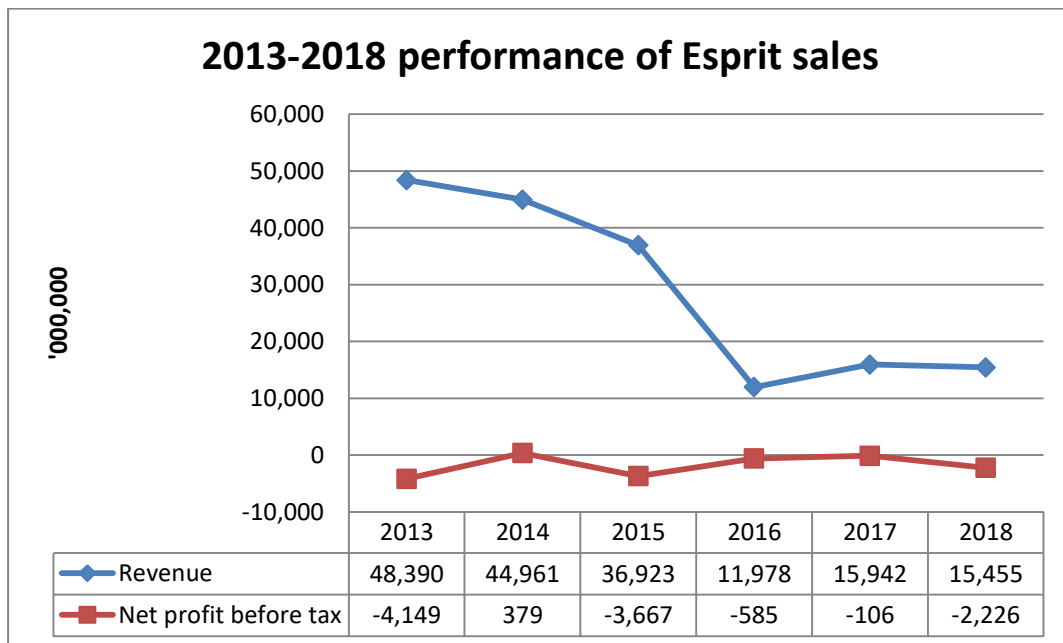


Chart 2.4.a 2013-2018 performance of Esprit sales

According to annual report of Esprit, the total net loss before tax in the past 6 years was more than HK\$ 10 billion. The company is definitely difficult to sustain if such poor financial situation cannot be improved immediately.

3. Current company business strategies



Product

- Esprit is a global fashion brand which has products like clothing, footwear, sunglasses, watches etc. Esprit likes to be seen as a brand which symbolises a blend of West coast Lifestyle, creativity and a sense of ecological responsibility. In product categories they have different sections namely Casual, Collection, Urban Casual, Sports, Kids, Accessories, Shoes and body wear (underwear, loungewear and swimwear for men and women). Esprit also offers watches and perfumes as a part of its marketing mix product portfolio.

Price

- Esprit keeps in mind its competition while pricing its products. The marketing strategy if Esprit included catering to a large segment of society who wanted value for money clothing and wanted to look fashionable as well as different than normal boring fashions. Their research showed that the customers wanted products which are outstanding to the money charged. So, to address the needs, Esprit offers a wide range of categories which had all sorts of pricing

requirements. Its premium collections offered premium pricing which were a lot formal in approach whereas it's casual and stylish products had offerings both in low range as well as high range.

Place

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Promotion

- Esprit promotes the brand by various media channels and in terms of their achievements. They won awards such as TM fashion online shop of the year and Top Marke Bodywear in Women's section. Some of the popular advertising campaigns include "make your wish- Christmas" with Esprit where they collaborated with iconic photographer Yvan Rodic, the Face-hunter. One more campaign was the "Iconic styles" where Esprit offered a look which can be transformed into a completely different and new look. This was in three

categories which were casual, business or glamorous. Other promotions include hiring popular artist Kevin Lyons who made playful illustrations in his magazine.



Company reforms

Esprit was very popular in 1980s to 1990s but when young brands such as Zara, H&M, Uniqlo, etc. entered the apparel market, its sales was substantially dropped. All of them targeted same customer group, however, Esprit's clothing design remained unchanged since 1990s with high price compared to the competitors. Old fashion, high price and long production cycle that make its competitiveness getting lower and lower. The consequence of all these problems caused Esprit loses its ground in the market share. Most of its revenue was come from Europe countries. Esprit's turnover in Germany in 2009 accounted for 45% of total turnover, and now Europe has become the area with the most losses. Esprit

announced that 65 of the 80 loss-making stores closed in Europe. The most frightening thing is that this has led to a decline in the confidence of agents.

Since 2011, ESPRIT's management has implemented different reforms. 2011/2012 launched a 18 billion four-year reform plan of which 6.8 billion was used for brand communication and plans to increase advertising by 6% to 8% of sales. 3 billion for refurbished retail stores in order to achieve an average sales growth rate of 8% to 10% in 4 years. They forecast there is an economic profit margin of 15% after the transition. In 2012/2013, the above four-year plan has been abandoned, and the advertising expense was significantly reduced. The promotion expense was set according to the sales ratio. Under the influence of fast fashion, the vertical model was implemented to reduce the time from clothing design to sales and also to increase product competitiveness. 2016/2017 proposes brand rejuvenation, set up a new independent team responsible for fast fashion and product upgrades; Omnichannel model distribution and invest more resources in e-commerce; Market size optimization and expansion and reduce costs. Restructuring the company structure and accelerating the closure of loss-making stores in the fiscal year 2018/2019 that cost 1.5 billion to 1.7 billion, expected to save 2 billion annual expenses after completion. In the new 5-year plan, look forward to restoring revenue growth in fiscal year 2020/21 and the compound annual growth rate of the fiscal year 2019/20 to 2023/24 can be higher. From the fifth year onwards, the Group's profit before interest and tax target is 5% to 7%.

ESPRIT is still optimistic about the Chinese market. It is expected that by 2023, ESPRIT will add 220 stores in China. Previously, ESPRIT had closed the stores in the Chinese market. According to the company data in 2017, ESPRIT closed 57 retail and wholesale stores in mainland China and 3 in Hong Kong. In the international market, ESPRIT aims to set the foundation and guarantee profits in the next 2-3 years, to reduce losses and build a strong foundation, reorganizing from stores, headquarters and tools, and expecting to break even within 2-3 years.

4. Conclusion

For the six months ended December 31, 2018, Esprit achieved revenue of HK\$6.766 billion, down 15.84% year-on-year. Compared with the loss of HK\$954 million in the same period last year, the loss attributable to Esprit's shareholders increased further to HK\$1.773 billion, an increase of 85.85% year-on-year. Compared with the current Esprit market value of 3.397 billion, that is to say, in the past six months, Esprit has lost more than half of the company's market value, the situation is very pessimistic. In 2002-2008, the company's performance was on the fast track and reached its peak in 2007, 2008 and 2009. However, since the company's performance hit its peak in 2008, it began to decline in profit as well as the stock price. Since the outbreak of the financial crisis in 2008, Esprit's global operations began to be affected. According to the company's disclosure, many customers were unable to place orders due to economic downturn and some customers even went bankrupt. The subsequent

reaction caused by this was that the wholesale channel was blocked, resulting in a large backlog of inventory. The company had to start low-priced clearance. However, what Esprit can't think of is that after this decision, the company began to go nowhere. In the past 20 years, Esprit has experienced a big change in prosperity and decline.

The management invited Zara coach Jose Manuel MARTINEZ GUTIERRE to become CEO in September 2012 with salary of 40.35 million Hong Kong dollars. After that, three other executives from Zara's parent company followed, and in the following years, the four-year transformation plan officially began. However, Jose Manuel MARTINEZ GUTIERRE's appointment does not seem to improve the dilemma. Because of the miraculous "Zara" model, it seems that it does not work in ESPRIT. In the following years, Esprit continued to fall all the way and management resigned one by one. The first to leave Esprit was Michael Ying, who led the company's listing. He resigned as chairman in 2006 and became a non-executive director. At the time, the company was still on the rise. Subsequently, in January 2008, when the company was at its peak, he resigned as a non-executive director and completely withdrew from management.

In the past 10 years Esprit has tried various changes, and the most prominent of which is the "Zara mode" strategy. However, with the failure of the Zara strategy, Esprit wants to draw a line with Zara for its next five-year strategy. In fact, since the beginning of this program, the difference between Esprit and Zara's business model has determined the outcome of the failure.

The well-known "Zara model" can be designed to be as short as 7 days, and generally 12 days, which is incredible for the clothing industry. After the former Zara coach Jose Manuel MARTINEZ GUTIERRE entered the Esprit team, the company implemented a vertical reform. However, the fastest speed of production can only be 2-3 months from design to ready-to-wear, it is still far away from Zara. The difference is mainly due to the fact that 50% of Zara's products come from their own factories and are heavy-asset companies, so they have absolute initiative in product source control. However, as a light asset company, Esprit is unable to achieve the true "Zara model" anyway.

Although it failed in the strategy of aligning with Zara, Esprit did have substantial growth in inventory and supply chain optimization and could not be the reason for Esprit's downside. The main reason is the loss of customers under the brand, and the essence of this result is bound to Esprit's own management problems. New CEO Anders Kristiansen found in the review of the company's business conditions that most employees do not understand the status quo of the brand.

5. Recommendations

Esprit has entered the Chinese market since 1998, but it has not seen improvement but also getting worse, the sales are much lower than Europe and Germany. A major reason for the downturn in the Chinese market is the design of existing products and size did not meet the needs of Chinese customers. This is fatal for a clothing brand. If the basic requirements of product are not fulfilled, then the customer's departure is understandable. During the 10-year downturn, Esprit constantly rethinks and tries to

change, but in reality it only focuses on size and form, ignoring the product itself. Currently, Esprit's fans on Instagram are only about 360,000, far lower than their competitors. What will happen to a fashion brand if losing young customers?



Although esprit has advertised top models, Gisele Bundchen, but the style of the clothes is still similar, classic, simple and the price is high. The design is not fashionable, the speed of changing style is not fast enough, and the taste is not accepted by most of the mainlanders. All these are very important factors to cause its failure, as well as lack of effective advertising. For example the sports brand “Lululemon” is relying on the continuous organization of offline community activities to attract more than ten thousands of diehard fans. Letting consumers and the store team promote the brand is the smartest and most effective way to succeed. Nowadays, advertising and marketing methods will be lost in the next five years. The industry operating rules of the apparel industry will become more and more entertaining.

Esprit should be more accurate in determining its market position, tailoring the tastes of mainlanders, or even “actively guiding” the consumption needs of mainlanders. In addition, to segment market demand into different marketing channels for young people or by income, to achieve more effective market sales purposes and increase turnover. Combined with current consumption patterns prevailing in the Mainland such as mobile payment. With the rise of Internet tools, physical stores will no longer be the only choice.

Saving money is undoubtedly the top priority. Last year, the newly appointed CEO has cut 35% to 40% of back office employees. In addition, the offices around the countries have been reduced or downsized, the fashion of high-end design has been reduced and strengthened the basic style. Close those loss-making shops immediately to narrow the loss. As of June 2019, the loss narrowed by 16% year-on-year.

Nowadays, the development of fabrics in the industry is very focused on reducing the consumption of natural resources. Both are vigorously developing environmentally friendly dyes. Therefore, from the design to the manufacturing process, clothing that pays attention to environmental protection will be more popular.

Last but not least, the biggest performance highlight of Esprit in its annual report is “no debt” and ample cash flow. According to the latest data released, the company's current cash flow amount of 3.636 billion Hong Kong dollars. It is its biggest margin of safety, and this money may provide the company with a chance to turn over.

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