COMPANY CASE

Coach: riding the wave of premium pricing

Victor Luis stood looking out the window of his office on 34th Street in Manhattan's Hell's Kitchen neighbourhood. It had been just over a year since he had taken over as CEO of Coach, Inc., a position that had previously been held by Lewis Frankfort for 28 years. Under Frankfort's leadership, it seemed Coach could do no wrong. Indeed, over the previous decade, the 73-year-old company had seen its revenues skyrocket from about €0.92 billion to over €4.6 billion as its handbags became one of the most coveted luxury items for women in the United States and beyond. On top of that, the company's €0.92 billion bottom line – a 20 per cent net margin – was typical. Coach's revenues made it the leading handbags seller in the nation. The brand's premium price and profit margins made the company a financier's darling.

Right around the time Luis took over, however, Coach's fortunes began to shift. Although the company had experienced promising results with expansion into men's lines and international markets, it had just recorded the fourth straight quarter of declining revenues in the United States, a market that accounted for 70 per cent of its business. North American comparable sales were down by a whopping 21 per cent over the previous year. Once the trendsetter, for two years in a row Coach lost market share to younger and more nimble competitors. Investors were jittery, causing Coach's stock price to drop by nearly 50 per cent in just two years. After years of success, it now seemed that Coach could do little right.

Artisanal origins

In a Manhattan loft in 1941, six artisans formed a partnership called Gail Leather Products and ran it as a family-owned business. Employing skills handed down from generation to generation, the group handcrafted a collection of leather goods, primarily wallets and billfolds. Five years later, the company hired Miles and Lillian Cahn – owners of a leather handbag manufacturing firm – and by 1950, Miles was running things.

As the business grew, Cahn took particular interest in the distinctive properties of the leather in baseball gloves. The gloves were stiff and tough when new, but with use they became soft and supple. Cahn developed a method that mimicked the wear-and-tear process, making a leather that was stronger, softer, and more flexible. As an added benefit, the worn leather also absorbed dye to a greater degree, producing deep, rich tones. When Lillian Cahn suggested adding women's handbags to the company's low-margin line of wallets, the Coach brand was born.

Over the next 20 years, Coach's uniquely soft and feminine cowhide bags developed a reputation for their durability. Coach bags also became known for innovative features and bright colours, rather than the usual browns and tans. As the Coach brand expanded into shoes and accessories, it also became known for attractive integrated hardware pieces – particularly the silver toggle that remains an identifying feature of the Coach brand today. In 1985, the Cahns sold Coach to the Sara Lee Corporation, which housed the brand within its Hanes Group. Lewis Frankfort became Coach's director and took the brand into a new era of growth and development.

Under Frankfort's leadership, Coach grew from a relatively small company to a widely recognised global brand. This growth not only included new designs for handbags and new product lines, but a major expansion of outlets as well. When Frankfort assumed the top position, Coach had only six boutiques located within department stores and a flagship Coach store on Madison Avenue. By the time Frankfort stepped down, there were more than 900 Coach stores in North America, Asia and Europe, with hundreds of Coach boutiques in department stores throughout those same markets as well as in Latin America, the Middle East and Australia. In addition to the bricks-and-mortar outlets, Coach had developed a healthy stream of online sales through its websites.

High price equals high sales

With the expansion in Coach's product lines and distribution outlets, women everywhere were drawn to the brand's quality and style. But perhaps more than anything, they were attracted to the brand as a symbol of luxury, taste and success. Over the years, Coach had taken great care to find an optimal price point, well above that of ordinary department store brands. Whereas stores that carried Coach products also sold mid-tier handbag brands for moderate prices, Coach bags were priced as much as five times higher.

It might seem that such a high price would scare buyers off. To the contrary. As Coach's reputation grew, women aspired to own its products. And although the price of a Coach bag is an extravagance for most buyers, it is still within reach for even middle-class women who want to splurge once in a while. And with comparable bags from Gucci, Fendi or Prada priced five to ten times higher, a Coach bag is a relative bargain.

With its image as an accessible status symbol, Coach was one of the few luxury brands that maintained steady growth and profits throughout the Great Recession. And it did so without discounting its prices. Fearing that price cuts would damage the brand's image, Coach instead introduced its 'Poppy' line at prices about 30 per cent lower than regular Coach bags. Coach concentrated on its factory stores in outlet malls. And it maintained an emphasis on quality to drive perceptions of value. As a result, Coach's devoted customer base remained loyal throughout the tough times.

At about the same time, Coach also invested in new customers. It opened its first men's-only store, stocked with small leather goods, travel accessories, footwear, jewellery and swimsuits. Coach also expanded men's collections in other stores. As a result, its revenue from men's products doubled in one year. The company saw similar success with international customers, pressing hard into Europe, China and other Asian markets.

But just as it seemed that Coach was untouchable, the brand showed signs of frailty. Coach's US handbag business started slowing down. During Luis' first year on the job, Coach's share of the US handbag market fell from 19 per cent to 17.5 per cent – the second straight year for such a loss. During that same period, Michael Kors, Coach's biggest competitive threat, saw its market share increase from 4.5 per cent to 7 per cent. Up-and-comers Kate Spade and Tory Burch also saw increases. Because the US market accounted for such a large portion of the company's business, overall revenue took a dip despite the brand's growth in new markets.

What's the problem?

Many factors could be blamed. During the most recent holiday season, Coach had to contend with the same problem many other retailers faced – less traffic in shopping malls. But Kate Spade and Michael Kors, which operate their own stores and sell through department stores in malls just as Coach does, experienced double-digit gains during the same period. Coach's performance also ran counter to the dynamics of the handbag and accessory market as a whole, which grew by nearly 10 per cent over the previous year.

The difference in sales trends between Coach and its competitors have led some analysts to speculate that the long-time leader has lost its eye for fashion. 'These guys are definitely losing share,' said analyst Brian Yarbrough. 'Fashionwise, they're missing the beat.' Yarbrough isn't alone. Many others assert that, under the same creative direction for 17 years, Coach's designs have grown stale.

Then there is the issue of Coach's price structure – in short, Coach may have taken the premium price point too far. 'Coach tried to eliminate coupon promotions tied directly to its discount outlets, which are the company's biggest source of revenue, and which attract customers looking to stretch their dollars,' said one luxury retail expert. 'The number of people willing and able to pay a premium for luxury brands, like Coach, is getting small as this weak economy continues.' However, price alone would not explain why Coach's business slid at the same time that sales by comparably priced competitors rose. Additionally, while Coach's North American revenues were down last year, sales of its high-end handbags (priced above $400) actually increased.

Some analysts have also questioned the effect of Coach's popularity on its image of exclusivity. A luxury brand's image and customer aspirations often rest on the fact that not everyone can afford it. But Coach has become so accessible, anyone that wants a Coach product can usually find a way to buy one. This availability has been fostered by Coach's outlet stores – company-owned stores that carry prior season merchandise, seconds and lower-quality lines at much lower prices. With the number of customers drawn in by low prices, Coach's outlet stores now account for a sizable 60 per cent of revenues and an even higher percentage of unit sales. Combine that with a healthy secondary market through eBay and other websites, and Coach products are no longer as exclusive as they once were.

Although new as CEO, Luis has been with Coach for the past eight years and oversaw Coach's international expansion. And although Frankfort has stepped down, he is still involved as chairman of the board. Led by these seasoned fashion executives, Coach has a turnaround plan. For starters, the company has hired a new creative director who, according to Luis, is 'providing a fashion relevance for the brand like we have never had'. Both the fashion and investment worlds anxiously await the first designs from the new regime.

In addition to the creative and design changes, Coach is rebalancing its product portfolio. To win back shoppers, Coach will be positioned as a lifestyle brand with greater expansion into footwear, clothing and accessories. Additionally, the company will increase the number of handbag offerings priced at €400 or more, a move that could raise the average price point of Coach's handbags. With all that the brand has at stake, those in charge will not give up easily. The question is, will the new strategy restore Coach to its former glory days?

Questions for discussion

1. What challenges does Coach face relative to pricing its vast product line?
2. Based on principles from the chapter, explain how price affects customer perceptions of the Coach brand.
3. How has increased competition at Coach's price points affected the brand's performance?
4. Will the plan proposed by current Coach leadership be successful in reversing the brand's slide in market share? Why or why not?
5. What recommendations would you make to Coach?

Sources: Andrew Marder, 'Coach, Inc. can't get it together', *Motley Fool*, 30 April 2014, www.fool.com/investing/general/2014/04/30/coach-inc-cant-get-it-together.aspx; Phil Wahba, 'Coach sales in North America plummet as market share erodes', Reuters, 22 January 2014, http://in.reuters.com/article/2014/01/22/coach-results-idINL3N0KW3V920140122; Ashley Lutz, 'Coach is slipping fast, and it can all be traced to one major mistake', *Business Insider*, 22 October 2012, www.businessinsider.com/coach-is-losing-its-value-2012-10; and additional information taken from www.coach.com/online/handbags/genWCM-10551-10051-en-/Coach_US/CompanyInformation/Investor-Relations/CompanyProfile, accessed January 2016.