

The Strategic and Financial Analysis of Hermès

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Abstract. Since the outbreak of the COVID-19 in 2019, the global economic development, including the luxury industry, has suffered a serious blow. As a leading international luxury brand, Hermès has been running their business successfully for 185 years and has just survived the crisis caused by the epidemic. It is well worth analyzing and discussing Hermès from the perspective of strategy and financial statements to provide reference and inspiration for the luxury industry and other industries that have not recovered from the negative impact of the epidemic. This article analyzes Hermès' internal environment, external environment and strategies by adopting PESTEL analysis, five forces analysis and SWOT analysis and discusses Hermès' financial position, results of operations and risk factors by analyzing its universal registration document. According to the strategic and financial analysis, it is apparent that Hermès was affected by the epidemic of short duration, but now it has got through the crisis and returned to strong growth.

Keywords: Strategy; Financial Analysis; Hermès.

1. Introduction

Hermès is the leading international luxury brand, founded in 1837 by Thierry Hermès in Paris, France. Hermès sells a variety of products including leather goods, saddlery, ready-to-wear, accessories, silk, textiles, perfumes, watches and so on in 306 stores in 45 countries worldwide. Hermès has a long history of 185 years and is well worth analyzing and discussing from the perspective of strategy and finance.

1.1 Background

In 1837, a harness manufacturer Thierry Hermès started a business in Paris, France, which is the origin of Hermès. For six generations, Hermès has been an independent, family-owned enterprise, whose entrepreneurial spirit has become its representative business model [1]. Hermès' sixteen métiers including leather goods and equestrian, women's silk and ready-to-wear, men's silk and ready-to-wear, shoes, belts, hats, gloves, jewellery, watchmaking, perfumes, beauty, furniture and art de vivre, tableware and petit h create productions that combine traditional culture with innovative spirit. Hermès' mission is to create unique and innovative products to meet customer needs and improve customer satisfaction and loyalty and its goal is to keep improving, adhere to the characteristics of manual technology and pursue the highest level of technology [2]. Since its establishment, Hermès has been insisting on three strategies: creation, craftsmanship and an exclusive distribution network. Hermès implements vertical integration strategy through partnerships and acquisitions, with over 58 percent of production integrated and 78 percent in France. Hermès has set up a loyal and ever-increasing customer community through its e-commerce platforms and outlet network. By the end of 2020, Hermès has operated 306 stores in 45 countries [3]. Hermès was affected by the epidemic of short duration, but now it has got through the crisis and returned to strong growth.

1.2 Motivation

As a family-owned business, Hermès has not only been running their business successfully for over 185 years, but also overcome the crisis and achieved strong growth after the epidemic. It is well worth analyzing and discussing Hermès from the perspective of strategy and financial statements. Most of the existing literatures take the luxury industry as the research object. The research on Hermès is only analyzed from a strategic perspective, without a comprehensive discussion on its financial statements. Since the outbreak of the COVID-19 in 2019, few scholars have studied the operation of

Hermès and paid attention to its success. The strategic and financial analysis of Hermès will have important theoretical and practical implications to provide reference and inspiration for the luxury industry and other industries that have not recovered from the negative impact of the epidemic.

1.3 Contribution

This article is innovative to combine strategic analysis and financial analysis to explore what measures Hermès has taken to deal with the economic and industry depression caused by the epidemic and the effectiveness of these measures, which would enrich the theoretical achievements in related fields. At the same time, the strategic and financial analysis in depth can provide investors and stakeholders with more information to help them make scientific risk estimation and investment decisions.

2. Literature Review

Hermès is the leading international luxury brand with a long history and has been operating their business worldwide successfully. The strategic and financial analysis of Hermès will be of great significance to study and forecast the development of the luxury industry. There are a number of articles focusing on luxury brands' strategies. Popescu and Ceptureanu introduce the strategies adopted by luxury brands in the context of new challenges related to social responsibility and present the results of a study on the attitude of European consumers towards the sustainability and transparency of the supply chain from luxury industry [4]. Serena Rovai takes three luxury brands as research objects, explores their specific strategies and processes when entering new markets, and finally finds that the degree of digitalization is the key factor affecting whether luxury brands can successfully enter new markets [5]. In addition, the research shows that, compared with the traditional "luxury retail" strategy, which is usually related to the exclusivity of the luxury industry, the reason why luxury brands successfully enter the Chinese market is more related to their "luxury digitalization" strategy, which can quickly attract public attention and a large number of consumers with high accessibility. Ji Li analyzes the macro environment for the development of China's luxury industry from two aspects: national policy and economic environment, and social and cultural environment [6]. He also adopts five forces model to discuss Hermès' competitive environment in the luxury industry and summarizes Hermès' overall, competitive and functional strategies according to SWOT analysis.

2020 is predetermined to be a year composed in history. The epidemic not only threatens people's lives around the world, but also has a huge negative impact on all professions and trades, including the luxury industry. Qinglong Ma believes that since the traditional business model of the luxury industry is dominated by physical stores and offline services, the epidemic will lead to a significant reduction in the income of the luxury industry [7]. This paper also analyzes how the luxury industry gets through the epidemic from three aspects: raising prices, broadening online sales channels and promoting product innovation. Wen Peiyu believes that the outbreak of the epidemic dealt a serious blow to the global economic recession, which had a negative impact on fashion brands at all levels. In response to the COVID-19, the product pricing of fast fashion brands may be adjusted with the trend of economic development due to the high price sensitivity of their target consumer groups, while the product pricing of luxury brands will remain unchanged or even increase because their target customers are less price sensitive [8].

3. The Analysis of Hermès

3.1 Strategic Analysis

3.1.1 PESTEL Analysis

The PESTEL model is an effective tool for analyzing the macro environment. P stands for political factors, including a country's political system, government policies and domestic and international

political situation. He stands for economic factors, including fiscal policy and monetary policy, which are relevant to the survival and development of enterprises. S represents social factors, including the social folkway and customs, cultural traditions, population size, geographical distribution and consumer psychology and habits. T represents technological factors, including a country's technological strength, achievements of scientific progress in an era and technological changes that affect the development of the industry. E stands for environmental factors, including climate, energy, resources and circulation, which make a difference to an enterprise's activities, products and services. L stands for legal factors, including laws, regulations, decrees and national law enforcement agencies.

(1) Political Factors: France is where Hermès originated and developed. France is the world's largest manufacturer of luxury goods and the luxury industry is one of the country's pillar industries, occupying a pivotal position in the national economy. French President Macron has given strong policy support to the luxury industry and emphasized fashion industry as "social currency" for French power and cultural influence since taking office in 2017 [9]. Macron's agenda on fashion industry also includes increasing considerable financing for French fashion start-ups through the public investment bank BPI and helping companies implement "partial unemployment" program during the pandemic [9]. In addition, the accelerated globalization process has provided opportunities for luxury companies such as Hermès to expand their business scope and increase their international market share. In 2021, Hermès achieved sales of €8,982 million, of which Asia accounted for the largest share at 58%, followed by Europe with 24% and the Americas with the fastest growth rate, up 52% on the previous year [2].

(2) Economic Factors: Since the 21st century, the trend of global economic integration has intensified. European luxury market has tended to be saturated, and therefore Asia Pacific and North Africa have become new markets for international top brands to explore. At the beginning of the epidemic, the global economic recession dealt a serious blow to the luxury industry. The major brands closed their factories and exclusive stores one after another, which led to sales decreasing significantly. At the same time, the cost of raw materials, labor and logistics rose sharply due to the epidemic, so luxury brands started several rounds of price increases. The continued impact of the epidemic has pushed the luxury industry into digital development. Luxury brands take to social media for digital marketing and open up partnerships with various platforms, resulting in significant growth in online sales. The effectiveness of China's epidemic control policy and the rapid development of digitalization and e-commerce have made the Asian markets represented by China a new growth area for the luxury industry. In 2021, the scale of China's personal luxury market reached nearly US \$73.6 billion, a year-on-year increase of 36%. According to Bain Capital's report, China is expected to become the world's largest luxury market by 2025 [10]. Moreover, in the wake of the epidemic, the natural anti-inflationary attribute of luxury goods made them financial products with investment value, causing the wealthy, who were less affected by the epidemic, to buy luxury goods.

(3) Social Factors: In the general perception of consumers, luxury goods are a symbol of wealth and status, and the higher the price of a luxury item, the higher the wealth and status of its owner. With the upgrading of people's consumption structure and demand, the consumer group of luxury goods has gradually expanded. Nowadays, influenced by irrational consumer psychology, some young people also pursue luxury goods beyond their own spending power. What's more, with the change of social customs, the decent dressing has become the embodiment of work and life etiquette. Luxury goods are not limited to the consumption circle of female office workers, but have become a common consumption demand of young men and women.

(4) Technological Factors: On the one hand, the widespread use of biotechnology has greatly enriched the cosmetic product range and functions. Luxury goods companies generally invest heavily for the research and development of biotechnology to enrich the functionality of their products. On the other hand, the rapid development of the Internet and digital technology has enabled the brand's global stores to operate online, as well as made online shopping more diverse and convenient for consumers, improving customer experience and satisfaction.

(5) Environmental factors: In the past, the luxury industry has been considered one of the biggest sources of environmental pollution. As the concept of sustainability and environmental protection takes hold, people's consumption structure and demands are changing significantly, which poses a huge challenge to the luxury industry. Luxury companies have had to start taking environmental protection and social responsibility seriously by substituting environmentally friendly materials for plant and animal materials and moving away from pursuing large offline retail outlets to opening up online sales channels.

(6) Legal factors: French President Macron passed a legal provision in 2020 to help brands recruit artisans, indicating support to the apprenticeship, which is the key to the transmission of luxury craftsmanship [9]. At the same time, the improvement and development of the law on the protection of intellectual property rights for luxury brands such as Hermès provides protection for the image and reputation of the brand.

3.1.2 Five Forces Analysis

Michael Porter argues that in an industry there are five basic competitive forces, namely potential entrants, substitutes, buyers, and rivalries between suppliers and existing competitors, which jointly determine the competitive intensity and profitability of the industry.

(1) Bargaining power of suppliers: Suppliers, as upstream enterprises in the industrial value chain, want to provide products with low quality but high price. With the deepening of forward integration of enterprises, the threat to suppliers will be greater and the bargaining power of suppliers will be reduced. Hermès has a wide range of products and a wide variety of suppliers, divided into two main categories: raw materials and human resources [11]. The bargaining power of general raw material suppliers is generally weak, but when faced with key raw material suppliers who are dependent on scarce resources, luxury brands generally have lower bargaining power. Therefore, luxury goods manufacturers tend to forward integrate and invest directly in the manufacturing of key raw materials in order to obtain these key elements [11]. In July 2020, Hermès acquired its supplier J3L, a benchmark company specializing in the advancement, fabricate and deal of metal parts. In terms of human resources, top designers often dominate the trajectory of a luxury brand. Hermès' products are famous for their traditional craftsmanship and the labor costs of the artisans account for a large proportion of its production costs.

(2) Bargaining power of buyers: Buyers, as a downstream group in the industrial value chain, want to buy products of high quality and low price. The higher the degree of product differentiation, the lower the bargaining power of buyers. The luxury industry's main customers are high-income individual consumers who are less price-sensitive and can accept the high price levels of luxury goods. Hermès' products are priced at the highest level in the luxury industry and its most popular leather goods require an "allotment" to purchase. Furthermore, the limited sales attribute of some luxury goods enhances their scarcity and value retention, giving luxury brands strong bargaining power over consumers.

(3) Threat of new entrants: Entrants can divide up existing market shares, reduce market concentration, stimulate competition among existing firms and reduce price cost differentials. The magnitude of the threat of entry for an industry depends on the barriers to entry and barriers to exit. In terms of barriers to entry, the luxury industry's leading brands have a long history of development and unique brand culture, making their customers highly brand loyal. Without historical and cultural background, the barriers to entry for new entrants are extremely high. Besides, top luxury brands such as Hermès, LVMH and Kering have developed economies of scale and new entrants will be in the dark tree in terms of cost structure and profitability. As a capital-intensive industry, the luxury goods sector requires huge investments in design and advertising. If the entrants fail to operate, the barriers to exit luxury goods market are seriously high.

(4) Substitutes: Product substitution is divided into direct product substitution and indirect product substitution, with the substitute product determining the upper limit of profit-making pricing in the industry. The strength of the threat of substitution is determined by the relative price performance of

substitutes, switching costs and the propensity of customers to use substitutes. There is little threat of substitution for luxury goods because of its scarcity, uniqueness and differentiation.

(5) Rivalry: Companies within an industry usually compete for market share using price wars, advertising wars, improved quality, product introduction and increased service. The luxury industry is intensely competitive among the top luxury brands. LVMH, Kering and Richemont have been expanding the trend of collectivization as well as international market through acquisitions and mergers, posing a great threat to Hermès.

3.1.3 SWOT Analysis

SWOT analysis lists the internal and external factors that have a significant impact on the production and operation of the enterprise according to the objectives of the enterprise, evaluates these factors, and determines the advantages, disadvantages, opportunities and threats of the enterprise. Hermès' strategies have been analyzed using SWOT Analysis model, as shown in Table.1 [6].

Table 1. SWOT Analysis of Hermès

	<p>Strengths</p> <ol style="list-style-type: none"> 1. Handcrafted products and quality advantages 2. Global market segmentation 3. Good after-sales and maintenance service 4. Long history and brand culture 	<p>Weakness</p> <ol style="list-style-type: none"> 1. High prices and tariffs 2. The family-style handicraft workshop model lack of systematic management 3. Low productivity
<p>Opportunities</p> <ol style="list-style-type: none"> 1. Private and personalized service 2. Internet and digital development 3. The legacy of corporate culture 	<p>SO Strategy</p> <ol style="list-style-type: none"> 1. Stick to handcrafted and high-quality products 2. Expand distribution channels 3. Customer relationship management 	<p>WO Strategy</p> <ol style="list-style-type: none"> 1. Bring in professionals to improve management capabilities 2. Increase artisans and workshops to improve productivity
<p>Threats</p> <ol style="list-style-type: none"> 1. Global economic recession 2. Fierce competition 3. Counterfeits 	<p>ST Strategy</p> <ol style="list-style-type: none"> 1. Define market and customers positioning 2. Improve anti-counterfeiting technology 3. Attract talented designers 	<p>WT Strategy</p> <ol style="list-style-type: none"> 1. Acquire and merge competitors 2. Control costs 3. Develop emerging markets

3.2 Financial Analysis

3.2.1 Analysis of Consolidated Balance Sheet

Table 2. Consolidated Balance Sheet of Hermès

In millions of euros	31/12/2021		31/12/2020		31/12/2019	
Goodwill	42	0.30%	42	0.38%	16	0.16%
Intangible assets	258	1.86%	221	2.00%	184	1.86%
Right-of-use assets	1,517	10.96%	1,446	13.08%	954	9.65%
Property, plant and equipment	1,881	13.58%	1,646	14.89%	1,542	15.61%
Investment property	9	0.06%	73	0.66%	78	0.79%
Financial assets	617	4.46%	368	3.33%	357	3.61%
Investments in associates	51	0.37%	49	0.44%	79	0.80%
Loans and deposits	59	0.43%	56	0.51%	58	0.59%
Deferred tax assets	546	3.94%	475	4.30%	511	5.17%
Other non-current assets	22	0.16%	24	0.22%	11	0.11%
Non-current assets	5,002	36.12%	4,401	39.82%	3,791	38.37%
Inventories and work-in-progress	1,449	10.46%	1,289	11.66%	1,133	11.47%
Trade and other receivables	333	2.40%	250	2.26%	318	3.22%
Current tax receivables	58	0.42%	63	0.57%	21	0.21%
Other current assets	257	1.86%	193	1.75%	199	2.01%
Financial derivatives	53	0.38%	121	1.09%	37	0.37%
Cash and cash equivalents	6,696	48.36%	4,733	42.83%	4,384	44.37%
Current assets	8,845	63.88%	6,650	60.18%	6,091	61.64%
Total Assets	13,847	100%	11,051	100%	9,881	100%
Borrowings and financial liabilities due in more than one year	24	0.17%	18	0.16%	30	0.30%
Lease liabilities due in more than one year	1,529	11.04%	1,447	13.09%	896	9.07%
Non-current provisions	26	0.19%	22	0.20%	29	0.29%
Post-employment and other employee benefit obligations due in more than one year	220	1.59%	275	2.49%	270	2.73%
Deferred tax liabilities	15	0.11%	22	0.20%	25	0.25%
Other non-current liabilities	45	0.32%	36	0.33%	33	0.33%
Non-current liabilities	1,860	13.43%	1,821	16.48%	1,282	12.97%
Borrowings and financial liabilities due in less than one year	1	0.01%	25	0.23%	21	0.21%
Lease liabilities due in less than one year	248	1.79%	196	1.77%	196	1.98%
Current provisions	115	0.83%	100	0.90%	101	1.02%
Post-employment and other employee benefit obligations due in less than one year	40	0.29%	28	0.25%	18	0.18%
Trade and other payables	535	3.86%	448	4.05%	480	4.86%
Financial derivatives	122	0.88%	29	0.26%	47	0.48%
Current tax liabilities	347	2.51%	218	1.97%	360	3.64%
Other current liabilities	1,168	8.44%	795	7.19%	800	8.10%
Current liabilities	2,575	18.60%	1,839	16.64%	2,024	20.48%
Share capital	54	0.39%	54	0.49%	54	0.55%
Share premium	50	0.36%	50	0.45%	50	0.51%
Treasury shares	(551)		(464)		(509)	
Reserves	7,142	51.58%	6,212	56.21%	5,256	53.19%
Foreign currency adjustments	178	1.29%	38	0.34%	139	1.41%
Revaluation adjustments	83	0.60%	106	0.96%	51	0.52%
Net income attributable to owners of the parent	2,445	17.66%	1,385	12.53%	1,528	15.46%
Equity attributable to owners of the parent	9,400	67.88%	7,380	66.78%	6,568	66.47%
Non-controlling interests	12	0.09%	11	0.10%	8	0.08%
Equity	9,412	67.97%	7,391	66.88%	6,576	66.55%
Total Equity and Liabilities	13,847	100%	11,051	100%	9,881	100%

Owing to Hermès' positive cash policy, the amount of borrowings and financial liabilities is at a relatively low level. The increase in Hermès' total liabilities from 2019 to 2021 mainly comes from the increase in lease liabilities, which is in connection with the increase in right-of-use assets above. Although Hermès' total liabilities have increased over the last three years, the rate of growth is lower than that of its total assets.

In 2020, Hermès' net income decreased slightly affected by the epidemic. But soon Hermès' net income has increased to €9.4 billion in 2021, a 60% increase compared to 2019, before the epidemic. Despite this, Hermès's equity is on the rise from 2019 to 2021 because of the continued increase in its reserves.

3.2.2 Analysis of Consolidated Income Statement

Table 3. Consolidated Income Statement of Hermès

In millions of euros	2021	Change	2020	Change	2019
Revenue	8,982	40.59%	6,389	-7.18%	6,883
Cost of sales	(2,580)	28.17%	(2,013)	-5.27%	(2,125)
Gross margin	6,402	46.30%	4,376	-8.05%	4,759
Sales and administrative expenses	(2,137)	25.78%	(1,699)	-6.44%	(1,816)
Other income and expenses	(734)	5.46%	(696)	15.23%	(604)
Recurring operating income	3,530	78.19%	1,981	-15.31%	2,339
Other non-recurring income and expenses			91		
Operating income	3,530	70.28%	2,073	-11.37%	2,339
Net financial income	(96)	11.63%	(86)	24.64%	(69)
Net income before tax	3,435	72.96%	1,986	-12.51%	2,270
Income tax	(1,015)	65.58%	(613)	-18.38%	(751)
Net income from associates	34	112.50%	16		16
Consolidated Net Income	2,454	76.55%	1,390	-9.45%	1,535
Non-controlling interests	(8)	100.00%	(4)	-42.86%	(7)
Net Income Attributable to Owners of the Parent	1,165	-13.25%	1,343	-18.75%	1,653

According to Table.3. [2,12,13], in 2020, Under the influence of the epidemic, Hermès' consolidated revenue, gross margin, operating income and net income decreased slightly compared to 2019. Communication expenditure included in sales and administrative expenses also decreased because of the postponement or cancellation of numerous events [12]. After taking a series of measures such as raising prices, widening online sales channels and controlling costs, Hermès' consolidated revenue, gross margin, operating income and net income demonstrate significant increases in 2021. The increase in depreciation and amortization included in other income and expenses reflects Hermès' proceeded ventures in improving production efficiency, expanding distribution network, optimizing information system and internal control [2].

From 2019 to 2021, the gross margin rate was 69%, 68% and 71% respectively, up by 3 points compared to 2020. This improvement originates from the measures of strengthening marketing, expanding online sales channels, reducing inventories and controlling costs [2]. In the same light, Hermès' operating income rate was 39% and net income rate was 27% in 2021, both ratios showing an apparent upward trend, which benefited from its strategies to deal with the epidemic.

3.2.3 Risk Factors

(1) Information systems and cyberattacks: Information systems where stores all the confidential information of Hermès affiliated with its suppliers, customers and employees are of foremost significance in the in the daily operation of Hermès [2]. As the digitalization and online sales get popularized, Hermès will rely more and more on information systems. The fractional or add up to inaccessibility of information systems could disrupt or paralyze the operation of Hermès. Cyberattacks

on Hermès' information systems could also result in the disclosure of the company's internal information about customers, suppliers and so on, which would cause immeasurable damage to the company's interests.

(2) Intellectual property and counterfeiting: The circulation of counterfeits in the luxury market not only violates Hermès' intellectual property rights, but also incorporates a negative effect on its income and brand image.

(3) Exchange rates: Hermès is confronted with foreign exchange risk because most of its workshops are situated in Europe, but most of its sales revenue comes from the Asian market and the American market, in which the currency in circulation is not the euro [2]. As of 31 December 2021, 79% of Hermès' revenue came from currencies other than the euro.

4. Conclusions

In conclusion, Hermès has recovered from the impact of the outbreak and is showing stronger growth. Although Hermès has a really good performance in 2021, there are still some issues to concern. As stated above, there are still some risk factors that could hinder Hermès' growth, including information systems and cyberattacks, intellectual property and counterfeiting, exchange rates and so on.

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