Luxury Wars: How Hermès Faced Down its Rival

Threatened by a sudden and hostile takeover, the Hermès family sought strength in unity and formed an elaborate defence to ensure the 130-year-old company remained under family control.

"It's not a financial fight, because we would lose that. It's a cultural fight" - Patrick Thomas, former CEO Hermès.

It's fair to say LVMH's hostile takeover bid for Hermès came out of the blue. In October 2010, Patrick Thomas, the first outsider to manage the family company, was cycling through France's rural Auvergne region when his LVMH counterpart, Bernard Arnault, called with a short message: LVMH had acquired a 17 percent stake in Hermès and was planning to buy more – a fact that would be announced to the press in two hours. The first thought that went through my mind, Thomas noted later, was that this was no way to do business in France. It was he insists, "ungentlemanly".

To the majority of the Hermès family Arnault was an unwanted interloper. He was seen as being ruthlessly aggressive, with a formula for success – mixing glitzy advertising and publicity stunts – entirely unsuited to the Hermès culture.

Arnault rejected suggestions that he posed a threat to Hermès' autonomy and brand, maintaining his only desire was to make the company more profitable. This lure of enhanced personal wealth was seen as a golden carrot for the upcoming sixth generation of the Hermès family. The only way to oppose Arnault, Thomas reasoned, was by presenting a united family front.

Authenticity, a family legacy

Hermès opened its first store in Paris in 1883 specialising in handmade saddles, bridles, and riding paraphernalia. After securing a two-year exclusive European patent on the zipper in the early 1920s the company expanded its product line to include luggage and ready-made clothes. Every item produced was handled by Hermès artisans, and on completion the product was inspected for quality and stamped bearing the artisans name and date.

This pride in craftsmanship continued as France industrialised, with Hermès resisting pressure to mass manufacture, instead establishing partnerships with secondary schools to ensure a reliable supply of artisans trained in the company's methods.

Instructed in the Hermès credo "that useful be beautiful" family members were put through an apprenticeship in leadership to honour, sustain and develop the family legacy of authenticity and quality without compromise.

Like many luxury players in the 1980s Hermès acquired stakes in other luxury groups to enhance internal skills and grow revenues but all management was kept in house; outsiders were deemed inauthentic. The uniqueness and mystique of the Hermès brand was based on this tight family control. It was a strategy that worked, ensuring Hermès maintained its position throughout the recent global economic slowdown ahead of luxury brands such as Gucci, LVMH, Burberry and Mercedes Benz.

Transforming a troubled business

The chronicles of Louis Vuitton reflect a very different story. When Henry Racamier took over from his mother-in-law in 1977, the company was struggling through a difficult period. It continued to control design but not always production and had delegated merchandising to specialists, often for a mere licensing fee. Racamier noted it was the retailers who were making the biggest profits and quickly resolved to transform Louis Vuitton into a vertically integrated operation, opening its own retail stores and looking beyond Europe to the burgeoning Asian markets.

By 1984 sales had increased 15-fold to US$143 million, with a 40 percent profit margin – nearly double that of its competitors. To finance global expansion Racamier sold stock in the company and merged with Moet Hennessey to form LVMH which immediately began to acquire other luxury brands including a stake in Hermès.

"Jazzing up" the industry

About this time, Bernard Arnault, who had spent several unsuccessful years in the Florida branch of his family's real estate development company, returned to Paris and entered the luxury industry. He acquired Boussec, a bankrupt textile company and sold off most of its assets keeping Christian Dior – a fading couture house.

Having studied Racamier's methods he set about vertically integrating his group, pulling all of the company's manufacturing licenses and returning the quality of its in-house artisans to luxury standards. He opened Dior shops worldwide and took direct control of marketing, using jazzier designs, huge advertising campaigns and attention grabbing events. His "ruthless" pursuit of talent and acquisitions contravened the industry's customs as he "stole" designers and aggressively acquired other luxury family-owned firms, firing founders and family members.

In 1988, Arnault began to buy shares in LVMH. After promising to support Racamier in a power struggle he allied himself with rival shareholders gaining enough support to install himself as chairman.

Hermès floated 4 percent of its shares in 1993, increasing the figure to 25 percent. In 2008 Arnault – concealing his actions through financial derivatives – bypassed the legal requirement to declare any ownership above five percent. After the death of former Hermès CEO, Jean-Louis Dumas, in May 2010 the company's stock value doubled on speculation of takeovers and family dissent. LVMH converted its derivatives, at a roughly 50 percent discount of the actual stock price, adding another 12.1 percent of Hermès shares to the 4.9 percent it already owned.

It was then that Arnault disturbed Patrick Thomas's country bike ride to inform him of his intent. Thomas responded viscerally. "If you want to seduce a beautiful woman," he said, "you don't start by raping her from behind."

Redesigning the ownership structure

In December 2010 Thomas, supported by 52 key family shareholders, moved to protect the family legacy against any hostile takeover bid by redesigning the ownership structure. He established a holding company that would prevent at least 51 percent of shares from Hermès family members being transferred for the next 20 years. The company would retain the right of "first refusal" in the event any participating family member wished to sell their shares. Most notably, it would limit its voting power regarding the appointment of directors to the Hermès board and top management.

The French stock markets regulator, Autorité des Marchés Financiers (AMF) approved the move which gave 52 family members control of 50.2 percent of the shares and voting rights without having to launch a public tender offer for the whole company. The AMF's decision was welcomed by Deminor, the leading European company focusing on the rights of minority shareholders, but its French equivalent ADAM (Association de defense des Actionnaires Minoritaires) appealed decrying the ruling as "unjust". ADAM deemed that because less than 10 percent of shares were now freely floating on the market liquidity was severely reduced, unfairly penalising minority shareholders. It argued all minority shareholders should have the right to a buyout offer.

In the meantime, the price of Hermès stock fluctuated wildly. The day before the ruling on the ADAM appeal the share price closed at an all-time high at €265, up 69 percent from a year earlier. The next day shares dropped seven percent and continued to fall shedding a total of 20 percent over the next three weeks. By late November 2011, when Hermès new holding group, H51, was officially set up, LVMH had increased its stake to 22.3 percent.

Post script

In 2013, AMF fined LVMH €8 million for violating public disclosure requirements. LVMH announced in a company statement that the conglomerate, although disagreeing with the fine, would not pursue legal action. Meanwhile Arnault has continued to increase the company's total Hermès stake to roughly 23 percent, describing it as a strategic, long-term investment.

When Thomas retired in February 2014 Axel Dupas, a sixth generation of the Hermès family, was announced as his replacement.