The Benetton Group

The annual August, 1994 closing of company operations would give Luciano Benetton, the head of the Benetton Group based in Ponzano, Italy, some time to ponder discussions of recent days about the way in which the Group's organization might best respond to growing competition in its most important markets for fashion apparel while extending the vision that had produced remarkable growth and recognition for three decades. Nearly perfect summer weather both brought with it the anticipation of an enjoyable holiday and optimism that the Group would be able to deal effectively with its latest challenges.

Two dominant schools of thought had emerged from the discussions. Both were based on a belief that the Benetton Group's "genius" lay in its ability to: (1) organize new markets for its products, (2) leverage its human and financial resources by encouraging others to own and operate stores in which products largely produced by contractor-suppliers were sold, (3) design items of apparel of good value reflecting needs for both fashion and utility among 15- to 35-year-old customers (in age or state of mind), and (4) invest in production technology and systems that would allow Italian production to remain competitive internationally.

One school of thought held that growing competition from organizations owning and controlling their retail operations, such as The Gap in the United States, H & M in Scandinavia, and Zara in Spain, required that Benetton take steps to provide greater support to its retailers in already-developed markets. The other argued for a longer-term global view of the kind that had guided Luciano Benetton in building the company in the past. Typical of this "strategic model" was an emphasis on the development of new markets in China and India served by production in those countries which also could provide low-cost product of acceptable quality to other non-European markets, helping retailers in those countries respond to demands for greater value from customers. Few in Benetton's management subscribed fully to one or the other of these views.

Benetton's Beginnings

The Benetton story was a remarkable and often told story of business development in the last half of the Twentieth Century. It began with four children left fatherless in a family of

---

James L. Heskett prepared this case as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

modest means in Treviso, Italy, a town on the flat plain of the depressed (at that time) Veneto region in the shadow of Venice. The oldest of the children, Luciano Benetton, had left school at the age of 14 to sell apparel. At that time, his 12-year-old sister, Giuliana, already was running a knitting machine in a local factory. Luciano sold his accordion and bicycle to his younger brother Gilberto to buy a knitting machine for their sister in order to start a business of their own making and selling sweaters at retail, formally incorporating it in 1965.

Limited resources required that the Benettons resort to a variety of means to produce and retail their products. Ultimately, this led to an integrated strategy that produced remarkably rapid international growth. Even though the first stores that they opened were highly successful, they realized that they did not have the capital required to expand the number of retail sites. Soon they had recruited others to invest with them in stores. As the network of stores expanded, other friends joined with them as agents who, in exchange for an override of 4% of sales to retail stores, agreed to find others to invest in stores with them, thus allowing the Benettons to concentrate their energy and capital on manufacturing. Agents were advised to find "clients" (prospective partners as store owners and operators) who reflected the Benetton "spirit." These were youthful, vigorous people, often in the age range to which Benetton's products were targeted, with the means to buy fixtures for a small store, preferably with no previous retailing experience that would inhibit their ability to operate in the Benetton mode.

Retail sales expanded so rapidly by this method that from the beginning of their enterprise the Benettons had to resort to a tradition typical of the Veneto region, the contracting of certain steps in production to acquaintances who in turn hired others to work for them. Not only did this shield them from the distractions of managing large numbers of production workers but it also provided flexibility in manufacturing capacity and a hedge against uncertainty in the marketplace. Only critical skills of product design and manufacturing steps essential to quality, such as cutting and dyeing, were controlled directly by the Benettons. (One such innovative manufacturing technique that was closely controlled involved the dying of assembled woolen sweaters from a natural state as opposed to first dying the yarn, enabling Benetton to produce on short notice sweaters in colors demanded by customers.) By this means, they quickly built a network with varying levels of control over all steps of distribution from clothing design and construction to retailing. The results provided the basis for one of the most remarkable business stories of the century.

Benetton sales in 1993 reached 2,752 billion lira ($1.7 billion). (Financial information is presented in **Exhibit 1**.) Its products were sold in more than 6,000 stores displaying the names of Benetton's core product lines (Benetton—basic styles, Sisley—more sophisticated styles, and 012—for children) as well as the United Colors of Benetton (larger stores with combined product lines), Benetton Uomo (for men), Benetton Donna (for women), Blue Family (denim products), DiVarese (shoes) and (shirts) located in 119 countries. Unlike many of its competitors who had taken advantage of lower costs in the Far East to produce most of their products there, Benetton production continued to be centered in the Veneto region. The company's products were, however, made in seven other countries, with a majority of the products produced for export. (Flows of finished product are shown in **Exhibit 2**.) By 1993, The Benetton Group employed 1,770 people, with about 800 engaged in administration and product design at its headquarters "village" designed by world-famous Italian architects and centered around the offices of senior management located in the restored Eighteenth Century Villa Minelli. Another 970 were engaged in the production of the Group's core products in the Treviso area. In addition, about 1,900 were employed by companies affiliated with the Group and 2,000 more in companies that had been acquired to vertically integrate the supply and production processes. It was, however, estimated that more than 40,000 other people had either invested in Benetton retail stores and factories or were engaged in selling and making the company's products worldwide.

The Benetton Group

The Benetton Group represented the core business of Benetton. It engaged in the manufacturing and distribution of clothing constructed from wool, cotton and other fabrics; undergarments; shoes; cosmetics; and accessories. In addition, The Group licensed the Benetton name for a number of other products ranging from eye wear to auto accessories, although licensing often was used as an intermediate step toward eventual partnership. It was a public company, having listed its stock on exchanges in New York, Milan, London, Rome, Turin, Venice, Frankfurt and Toronto. The Benetton family, however, continued to own 71.5% of the stock which in total had a market value in excess of $2 billion at the end of 1993.

Family investments, financed by earnings of the Benetton Group, were in turn managed by a holding company, Edizione Holding, whose primary investments controlled Benetton Sportsystem made up of well-known brands such as Nordica (ski equipment), Prince (tennis equipment), and Rollerblade. Care was taken to separate the management of Edizione Holding from that of the Benetton Group. However, family members controlled the majority of the board of directors of both organizations. When a business developed under Edizione Holding, such as the underwear design and manufacturing company, Undercolors, was thought to be closely related to that of the Benetton Group, assets and other financial accounts were transferred to the latter. Other businesses, such as Benetton's Formula One racing team which was regarded as an advertising vehicle, were made a part of the Group upon acquisition.

All four founding Benettons, ranging in age from 50 to 59, continued to be active in the management of the Benetton Group. Responsibilities reflected the skills and interests of each. Luciano Benetton, the oldest, had the broadest interests and was primarily responsible for the development of the Benetton model of operation. Most of his time was, however, devoted to commercial activities, which included relationships with agents as well as involvement in the company's communications strategy and public relations work. Giuliana continued to design woolen items of clothing as well as play a significant role in the development of the company's product line and the technical aspects of making sure that it could be produced at reasonable cost. Based on her intricate knowledge of knitting machinery (even though she was said never to have read an instruction book), she had helped develop software for a new electronically-controlled knitting machine that could knit a sweater from a single strand of wool. Gilberto Benetton devoted most of his attention to financial affairs. And the youngest of the four, Carlo, was involved on a day-to-day basis in the planning and management of the company's manufacturing plants.

In 1982, with the urging of the company's bankers, the Benettons began assembling a senior management team with whom they could work. Aldo Palmeri, an executive from the state-owned Banco d'Italia who had been assigned to consult with the Benettons for two years, was the first to be hired. He replaced a managing director who was said to keep the accounts of the business in a little black book. Palmeri soon hired others. By mid-1994, the senior management team comprised Giovanni Cantagalli, an executive from 3M's Italian subsidiary who was the first to be hired by Palmeri after his arrival and who was responsible for international business development and human resources; Luciano Cencherle, the director of production hired in 1993 from Marzotto, a Benetton supplier of fabric; Marco Polo, chief financial officer who was brought to Benetton from a position as Citibank's country treasurer in Italy in 1993; and Mauro Benetton, marketing director, who was Luciano Benetton's oldest son and had worked for 12 years in various positions, including the head of the company's Sisley brand and Benetton's U.S. operation, after joining the company at the age of 19. Although an "owner," as members of management referred to family members, Mauro Benetton had earned general acceptance among his peers on the management team as one of them. In Palmeri's words, "Everybody has to justify his existence here, Benetton or not." Rounding out the senior management staff were Laura Pollini, director of Image and Communication, and Franco Moretti, director of Legal Affairs.

Over the years, members of senior management had at times felt "sandwiched" between the next level of management reporting to them, many of whom had been hired by the Benettons, and the "owners" themselves. This was due in part to an open atmosphere in the company in which managers at all levels were free to meet with (and sometimes appeal their cases to) members of the family. The phenomenon extended to those with whom Benetton did business. For example, nearly all agents had been engaged by and were acquaintances of Luciano Benetton. Over the years, with Benetton's success, they had become very wealthy and influential. They regularly aired their grievances with Benetton during his frequent visits to the field, complaining about various company policies and the actions of individual members of management.

Several children of the founders had rejoined the company, further complicating the roles of managers to whom they reported. Luciano Benetton had a second son, Alessandro, who began handling acquisitions in Edizione Holding and heading up the Formula One racing business for the Group after completing his MBA at the Harvard Business School. Two of Giuliana's daughters, Paola and Daniela, were also employed. Paola worked with her mother in the design of woolen fashions. Daniela headed up the Undercolors venture. It was thought that one or two other children of the founders might decide to join the company in the future. Members of senior management understood and accepted the notion that one of their tasks was helping prepare the next generation of owners for the company. Senior members of the family displayed little, if any, favoritism toward their children, nieces, or nephews. In fact, in the opinion of many managers, members of the next generation would have to prove themselves unusually adept at management to win promotion. An organization chart for the Benetton Group is shown in **Exhibit 3**.

The Benetton Culture and Model

The Benetton culture was centered around concepts of entrepreneurship (free enterprise), innovation, partnership, and trust. These values were visibly manifested in the Group's attitude toward contracts, with partnerships with joint venture partners typically formed on a 50/50 ownership basis and maximum latitude given to (and minimum structure imposed on) partners as well as employees. As a consequence, employees who were not comfortable in an environment without job descriptions or organizational constraints didn't stay long with the organization. Ideas were conceived and implemented with a minimum of planning and control. Instead, Benetton was known in Italy as an organization that hired the best people and relied on them to do "the right thing," sometimes producing mistakes that were quickly forgotten as it moved on to the next idea. In addition, the Group was operated with the "one world" vision of Luciano Benetton, who was the driving force behind its global development.

This set of values fostered an approach to the market that allowed the fastest possible rate of growth. Individuals with the ability to raise $70,000 (to buy fixtures for a 600- to 1,000-square-foot shop) and "the right attitude" quickly could become Benetton shopowners. Early on, this involved nothing more than a handshake with Luciano Benetton or (later) with agents who had recruited them in their territories. No fees were paid to acquire the right to display Benetton's sign and merchandise. Merchandise was supplied on such liberal credit terms (with payment due an average of 120 days after the beginning of a new merchandise season) that essentially it was financed by Benetton. In return, shopowners agreed to sell only Benetton merchandise and not to return any merchandise once it was delivered to them.

Benetton called its shopowners licensees to distinguish the relationship from franchising, which legally (in the United States) included a fee for the use of a name and a more formal written agreement. The administration of licensees was the responsibility of 83 agents worldwide, each of whom was given exclusive territorial rights to develop Benetton retail shops. Agents were expected to take a minority investment in each store (usually about 10%), display each season's line of merchandise to licensees, and assemble orders for merchandise according to the schedule required by Benetton. Although agents did not have ownership of Benetton products (other than as investors in shops), theoretically they were responsible for insuring the credit of licensees and collections for merchandise shipped. In fact, however, upon failure by licensees to pay Benetton's invoices, Benetton typically negotiated a settlement that was intended to recover as much of the licensee debt as possible. In return for their services, agents were paid 4% of the value of goods shipped from Benetton's warehouse complex in Italy. This method of market development provided for rapid growth. By the end of 1993, 6,113 Benetton stores worldwide (of which only 35 largely "flagship" stores in large cities were owned by Benetton) represented 8,509 "points of sale" (separate store areas for displaying Benetton, Sisley or 012 branded merchandise), as shown in **Exhibit 4**.

This system allowed Benetton to book shipments as sales, easily finance receivables for merchandise that could not be returned, and control its order flow to manufacturing plants. In regard to the latter, licensees were expected to place an order for "base" stocks comprising 70% to 80% of the total about six months in advance of a new season. This allowed Benetton to schedule its production on a level basis and ship to licensees by the lowest cost method. Licensees were then afforded the opportunity to take advantage of what was called "reassortment," involving the ordering of certain popular products once patterns of demand were known during a season. Rapid replenishment of these items involved such things as the dyeing of already-assembled woolen items and the use of rapid response logistics utilizing an automated master distribution center in Italy and air freight for intercontinental shipments. The replenishment of "reassortment" orders from licensees could be accomplished in as little as 10 days.

The intent of this process was to provide inexperienced retailers with assurance that they could order a complete line of merchandise for display at the beginning of the season knowing that if they made mistakes they could effect recovery during a season. This, combined with a highly-focused line of woolen products, helped licensees achieve the Benetton goals of enabling a licensee to: (1) have 80% to 90% of ordered items in the store at the beginning of the season, (2) sell fully 85% of all merchandise at full margins, and (3) limit price reductions to end-of-season clearances on the remaining 15% of the merchandise at times suggested by the manufacturer. In the early 1980s, this system became the wonder of the retailing world. In more recent years, with the onset of competition and the rapid expansion of the product line from roughly 800 to 2,500 items for each of two seasons, it had become increasingly difficult for licensees to adhere to the model.

In addition to financing only those assets that were easily financible, Benetton further leveraged its resources by farming out as much as 85% of its production (largely non-strategic, labor-intensive processes such as garment assembly and finishing) to some 500 contractor organizations, often owned by Benetton friends and employees, in the region surrounding its factories in the Veneto. These contractors, often working only with verbal agreements, were assigned orders long before the start of a new season. During a season they were allotted "batches" of work every 15 days upon the completion of the previous batch. In return for assurances of work, subcontractors had to agree to: (1) purchase the latest processing equipment, (2) operate their factories on a 24-hour basis if necessary, (3) make available to Benetton any process improvements, and (4) pay for work needed to fix production of poor quality. Benetton's system of using more than one contractor for various processes associated with a single garment insured that every garment would be checked for quality by subcontractors as they received new batches of work. This enabled them to make corrections and charge the costs back to the subcontractor responsible for poor quality.

Because they received payment for their work roughly 60 days after delivery, subcontractors helped finance Benetton's inventory. More important, because contracts were agreed to on a season-by-season basis, they provided flexibility in Benetton's production capacity that enabled it to maintain a smaller, fully-used labor force engaged primarily in cutting, dyeing, quality control, and the preparation of shipments to retail stores. In recent years, investments had been made in "upstream" companies producing yarn and fabric for use in Benetton products. In addition, investments had been made in companies producing shoes, cosmetics, apparel accessories, and other items that could be retailed through the company's network of stores.

By 1983, Benetton had developed a noteworthy advertising and image campaign. It was intended to convey a "one world" theme befitting a global company and featured young people of various races dressed in Benetton clothing in playfully loving poses over the company's logo, "The United Colors of Benetton." It was displayed (in English) on billboards and in magazines all over the world. An example is shown in **Exhibit 9**. In 1989, Luciano Benetton and a famous commercial photographer, Oliviero Toscani, who had helped develop the United Colors campaigns, decided that Benetton's clothing was sold in so many different markets, each one preferring different styles, that the company should turn to ads featuring not products but photos that stimulated thinking about a number of social issues overprinted only by the company's now famous logo. From 1989 on, nearly all of Benetton's corporate advertising budget was devoted to photos portraying such things as a young woman dressed in a nun's habit kissing a priest, a black arm handcuffed to a white one, a newborn baby just seconds old with its umbilical cord still attached, and a person moments before death from AIDS in the presence of his family. (As shown in **Exhibit 10**.)

Other elements of Benetton's communication strategy included the shops themselves, which were thought to be the best way of "advertising" product; Colors magazine, a Benetton publication featuring products as well as stimulating and controversial articles; a Formula One racing team that had achieved both racing success and publicity for the company; the sponsorship of professional basketball and volleyball teams as well as other athletic endeavors; and a new center, Fabrica, designed to stimulate creative participants from all over the world to produce new commercially artistic ideas and ways of communicating them. In total, Benetton's communication strategy made the United Colors of Benetton one of the world's best-known brands on a total cost to the company of about 4.5% of sales, significantly lower than other companies building global brands.

Strategies for International Expansion

Over the years since its first expansion beyond Italian borders, Benetton had experimented with various strategies. This had evolved into a several-stage process that described many of its international relationships. The stages involved: (1) "cloning" the Italian experience by establishing a Benetton agent in a foreign country supplied with product from Italy, (2) developing local production capability selling to licensees served by agent/co-shopowners, (3) establishing a 50/50 partnership with a local organization for the further development of a market, with or without local production, (4) after the proven success of the partnership, exercising an option to buy out the partner and consolidating the operation under Benetton management, and (5) integrating a foreign subsidiary into the global network by establishing local production capability to serve both the local and other markets, exporting and importing both finished goods and raw materials to and from the country. This enabled Benetton to test market potential and the ability of partners, agents, and licensees to adopt the company's model before investing large sums of management time or capital. Even after the acquisition of a partnership, production could be delegated to contractors supplying some of their own capital.

Benetton's business organization in countries like Egypt, India, Turkey, Argentina, and Mexico were examples of stage three development. With the establishment of a strong presence in Japan under a stage three agreement, recently a 90% share of the Japanese partner had been purchased, creating a stage four operation. France and Spain were the only two existing examples of stage five operations, even though the plants in each country manufactured only a limited line of products and shipped most of their output to other markets. It was thought that China and India offered great potential for stage five operations.

Competitive Challenges

Competition for casual fashion, some of which was inspired by Benetton's success, had become more severe. It featured the development of rapid-response capability, low-cost Far Eastern production, the creation of larger, more exciting retail store environments, and a good understanding of certain national market preferences. In the United States, chains such as The Limited (featuring stores named The Limited, Limited Express, Structures, and Victoria's Secret) and The Gap (Gap and Gap Kids) had ridden imaginative merchandising, focused product line development, and low-cost Far Eastern production to strong growth and profitability. (See **Exhibit 5** for competitive data.) In Europe, Swedish-based H & M was employing the same general strategy, opening stores of up to 20,000 square feet. It had penetrated as far south as France. Zara, based in Spain, was growing its stores from the South and also had reached the French market. Recently, The Gap had branched out from a 40-store base in the United Kingdom, its first venture in Europe, to open its first store in Paris.

Impact on Benetton

In spite of increasing competition at the retail level, Benetton's shipments had continued to grow, as shown in **Exhibit 6**. By mid-1994 its stock, although thought by Palmeri and Polo to be undervalued, had more than doubled in the preceding 18 months and was selling just below its all-time high. Its value represented 1.8% of that of all the firms listed on the Milan Stock Exchange, where it was very heavily traded and had far outperformed the market. Even its Formula One racing team was doing well, having come from nowhere to take the lead in worldwide competition from competitors such as Ferrari, an achievement not overlooked in Italy.

In 1993, 79% of the value of Benetton's invoices to retailers was associated with the shipment of basic manufactured clothing products (which represented much of the output generally referred to inside the company as the Grupo Ristretto, or core group), with the remaining 21% (up from 15% two years earlier) derived from the manufacturing of shirts, shoes, intimate wear, cosmetics, and accessories. Of the core group products, 36% were sold in Italy and another 49% in other European countries (with Germany and France by far the most important of these markets), as shown in **Exhibit 7**. The success of the company's licensees and partners varied from market to market (and from currency to currency), as suggested by the experiences in Japan and the United States.

Japan Experience

Benetton's experience in Japan represented a success story relative to other foreign companies' experiences there. In just eight years' time, it had seen more than 600 retail shops opened there, even though the company had realized little profit on its Japanese business, primarily because of the high cost of production in Japan and the increasing emphasis on value among Japanese consumers.

In 1983, Benetton established a "representation office" in Japan to assist market development. Shortly thereafter, Luciano Benetton signed a licensing agreement with the Seibu Group, one of Japan's larger retailers. Under this agreement, Benetton would lend its name and Seibu its resources in the licensing of retail store owners and the development of the Benetton brand in Japan under an agreement providing for 50-50 ownership at Benetton's option at any time during a five-year period of the new partnership, named Linz. A year later, Benetton Japan, a wholly-owned subsidiary of Benetton, was established when Takashi Endo, a former buying officer in Italy for the Seibu Group, was sent by Benetton from Italy to run an office with responsibilities for managing the licensing of Benetton products and growing the Sisley (casual clothing for young men and women) business, a wholly-owned Benetton business representing an investment of about $5 million in four stores along with a minority investment in 50 other Sisley stores, primarily financed by royalties from other Benetton labelled products licensed and sold in Japan.

Given good performance by the partnership, Benetton exercised its option to acquire at no cost a 50% share of Japanese operations, with a Seibu Group executive placed in charge. When the Japanese became dissatisfied with decisions being made in Italy, claiming that Benetton "didn't know the Japanese market," and Benetton's management in turn became dissatisfied with the management of the joint venture, Giovanni Cantagalli negotiated a deal to have Takashi Endo assume operating leadership of the joint venture, promoting the Seibu Group executive to Chairman. In 1993, Benetton purchased 80% of Seibu's interest, increasing its ownership to 90% of Linz.

The agent system in Japan had, according to one Benetton executive, "proven nearly useless. They are used to operating in a distribution system that rewards participants whether they do anything or not, and they do nothing for their 4% royalty." Stores typically ordered not on expectations, but on historical experience. In 1993, 80% of all goods sold in Japan were produced there. The remainder, primarily woolen items, was shipped from Italy. While it met quality goals, this produced a cost "mix" that yielded operating margins for Benetton that were only two-thirds of the 39.2% company-wide average for net profits on sales. Operating income was only about one-fifth of the company's 7.4% average for all operations. Equally important, the expanded responsibilities for Endo in Japan had resulted in a decline in performance of Sisley. While costs were being reduced, Sisley's sales also had fallen from a level of 23 billion yen at 8.6 lira to the yen in 1990 to one of 18 billion yen at 15 lira to the yen in 1993, nevertheless producing an increase in lira denominated sales to Benetton. Trends in operating statistics for Benetton in Japan are presented in **Exhibit 8.**

In recent weeks questions had arisen about the desirability of continuing production under the control of the Japanese joint venture. Because of Japanese perceptions that the quality of product produced in Italy was inferior to that of Japanese production, the product line being presented to stores by Japanese agents excluded most of the more colorful woolen items imported from Italy, resulting in what was described by one executive who had accompanied Luciano Benetton to Japan to check out the situation as "a small, quiet collection" in the stores. Although Japanese executives and agents were persuaded, after hours of discussion and a close examination of the latest Benetton collection from Italy, that Italian quality was the equivalent of Japanese quality, the decision had been made to more than double in 1994 production in Italy for the Japanese market. This would result in a 20% reduction in product costs.

U.S. Experience

In late 1979, Luciano Benetton realized his long-standing ambition to open a retail shop in New York City as a way of researching the U.S. potential for the company's clothes. After unsuccessful experiences in licensing department stores to open Benetton boutiques on their premises, Benetton's European agents were given an opportunity to expand the scope of their operations by electing to add territories in the United States. Thirteen did so, assuming exclusive rights to nearly all of the country. Benetton established what was termed a "manufacturer's sales office," Benetton Services Corporation, locating it in New York City to provide a public relations presence in the United States, work with agents in the selection and display of new collections to licensees, and help agents collect orders from licensees.

Expansion was immediate and rapid. By 1988, there were 800 stores offering more than a thousand store/product line combinations to the public. In 1985, Benetton opened a factory in Rocky Mount, North Carolina to manufacture cotton goods. Agents and many shopowners achieved substantial wealth from their ventures.

By 1987, Benetton licensees were becoming troubled by several disturbing trends. These included unfavorable dollar-lira exchange rates, increasing competition, alleged company practices that they regarded as unfair, and the company's image advertising campaign.

As the dollar fell against the lira in the late 1980s (from 2,170 lira to the dollar in August, 1985 to 1,160 in December 1987), the dollar costs of Benetton's merchandise to U.S. licensees rose dramatically, making it less competitive with U.S.-based competitors who contracted for most of their production in the Far East. Consistent with Luciano Benetton's vision of maximum latitude for entrepreneurship and self-determination for Benetton's shopowner/licensees, the Benetton Group offered no price relief to licensees. Several began closing their shops.

U.S.-based retail chains such as The Limited and The Gap had stepped up competition. They were operated under strategies quite different from Benetton's that included strong central direction; close control of stores operated in leased space contracted by highly-experienced real estate departments; the ownership of all retail inventory; the subcontracting of manufacture largely in the Far East; fast-response supply chains that enabled them to "knock off" (copy) other designs (including Benetton's), adapt them (often with computer-aided design), and make them available for sale within several weeks after competitors introduced them; and the hiring, training, and control of all store personnel, who were employees of the chains. While these strategies required huge infusions of capital, they had proven very successful.

Owners of small Benetton stores found themselves in competition with well-located, new stores of up to 4,500 square feet, requiring investment of $300,000 to $500,000, designed to be more exciting in appearance, offering a wide line of merchandise, and staffed with better-trained salespeople.

With declining performance among licensees came charges of unfair practices on the part of Benetton. These included allegations that Benetton shipped clothing that had not been ordered or that was damaged and did not allow the shipments to be returned, that agents opened stores near theirs or threatened to do so if they refused to open new shops themselves, that agents had misled prospective licensees about the profitability of owning a Benetton store, and that Benetton's agents were hard to reach when problems arose. Several law suits resulted from these charges, but all were either settled or thrown out of court because licensees were judged not to qualify as franchisees under U.S. franchising laws.

Benetton's advertising featuring social issues, while regarded as controversial by some, nevertheless appeared to appeal to many young adults to whom they were directed. But some magazines in the United States refused to run the ads. Some customers complained to licensees who assumed that the ad campaigns were hurting their sales.

Regardless of the reasons, Benetton retailers' sales and the number of shops in the United States declined steadily. Lira sales in 1993 were less than half those of just three years earlier. When Mauro Benetton assumed responsibility for the United States in early 1991, he faced a number of challenges. Licensees were confused by a product line that had tripled in number of items over the years. Because their sales were declining, licensees were more hesitant to place base stock orders in advance of the season. With an increasing product line, "reassortment" could be offered only a limited number of items, increasing the perceived risk to licensees of ordering the "wrong" merchandise. With declining sales, payments became a problem. Slow payments further delayed the shipment of orders, backing up production and logistics. Finally, many Benetton stores had not been refixtured for seven or eight years in a business where refixturing every five years was thought to be necessary. Further, all were small, roughly one-third the size of many competing stores. With declining demand in the United States, the North Carolina plant was closed in 1993.

In order to at least stop the decline, Mauro Benetton and Carlo Tunioli, the head of Benetton Services in New York, had begun to channel the meager funds over which they had discretion into services for licensees. By contracting on an as-needed basis with consultants, they began providing help in the training of personnel, real estate, architecture, and visual display. A display book was produced to suggest ways in which stores and windows could be arranged. To reduce confusion among licensees, the number of items in a typical line of merchandise was narrowed by two-thirds by U.S. agents and the Benetton Services staff before items were even offered to licensees for purchase. When one of six remaining agents in the United States went out of business, Benetton Services stepped in and began providing agency services in the Southeastern United States, collecting the 4% agency royalty in order to barely cover the expenses of roughly $150,000 to service the region. Trends in Benetton's U.S. operations are presented in **Exhibit 11**.

By mid-1994, there were only about 150 Benetton stores remaining in operation in the United States. But sales to U.S. licensees had stabilized, Benetton losses of more than $10 million per year (much of it in bad debts) had been stopped, and ways were being sought to regrow the market. These included repositioning Benetton's products to target young working women as opposed to teenagers (to reflect evolving sales patterns realized by licensees); encouraging reluctant existing licensees to open larger, refixtured stores by creating several success stories; diverting some of the funds for corporate "image" advertising featuring controversial photos to the advertising of the repositioned line of Benetton products; and even organizing an annual meeting of Benetton licensees where they could discuss common problems and work out solutions with Benetton Services. All of this was done with about $2 million of discretionary funds carved out of the $3 million budgeted by Benetton in Italy for corporate advertising in the United States (in addition to another $2 million to operate the office and provide basic order tracking and other services).

Actions at Benetton Services Corporation raised questions in the minds of U.S. agents about their future role in the Benetton network. Some of the actions were also questioned by members of Benetton's management in Italy, including Luciano Benetton himself, as running counter to the concepts of minimum Benetton involvement and maximum self-determination for agents and licensees joining the Benetton network.

Financial Hedging

Back at Benetton's newly-expanded treasury department in Ponzano, Marco Polo's staff was doing its part to provide hedges against future currency fluctuations in the lira, dollar, and other currencies. Shortly after a large devaluation of the lira early in 1993 that took the lira to a recent low against other currencies, it sold over a billion dollars of foreign currencies while purchasing an equal amount of lira. This was sufficient to cover three years of Italian production for export (representing about 30% of its total costs) and locked in an exchange rate of 1,600 to the dollar (vs. 1,200 to the dollar the previous year when Benetton's products were priced out of competition).

The Future

The significance of Benetton's experience in the United States was a matter of some debate at Benetton headquarters. One view was that it was a precursor of what Benetton would experience in Europe, where the consequences could be much more significant to the Group than in the United States. Those holding this view argued that the key to Benetton's success was its network, at the core of which were its licensees. While the Benetton model worked wonders fostering rapid growth in developing markets, they argued, it did not provide sufficient support in more mature, competitive markets or during periods of declining demand. Licensees with limited retailing experience and capital were thought by these executives to be no match for well-financed, centrally-controlled operators of much larger competing stores. Unless steps were taken to help them remain healthy, nothing that could be done elsewhere in fashion design or manufacturing at Benetton would compensate. This set of arguments raised questions about changes in the role of agents in highly-competitive markets. Current agents, it was argued, were generally "fat" from preceding successes. While their share of retailing profits might have declined, they still received the bulk of their income from their 4% commission on manufacturer shipments to stores. Many appeared not to have the incentive or the knowledge to help licensees prepare for changing competitive conditions. To abandon the agency system entirely, however, was estimated by one manager to require the creation by Benetton of an organization of at least 500 people to work directly with retailers. He questioned whether this made sense in a company that had prided itself on leveraging its human resources and preserving its flexibility.

There was little debate about whether or not Benetton should invest its own money in retail shops, a part of the network that its management did not know well. Most agreed that this kind of investment represented far greater risk than design, manufacturing, and distribution. Nevertheless, it was a question that remained to be answered by those advocating greater Benetton involvement downstream in the network.

Another important point of view, subscribed to in part or whole by others at headquarters, maintained that concerns about the implications of the U.S. experience were valid, but that they represented a shorter-term view that did not take fully into account the Group's plans for markets such as India and China. Because of currency regulations and exchange rates, this would require that Benetton expand its manufacturing capability in these countries, enabling it to increase exports as well. Thus, the initiatives not only were intended to foster Benetton sales at retail but also to support the development of low-cost manufacturing capability for products of acceptable quality in other markets. This would enable Benetton to ship significant quantities of product to markets such as the United States from countries with weaker currencies, thus insuring competitive value for Benetton's products.

Benetton already operated a joint venture in India. This involved an organization of agents and licensees as well as manufacturing capability. Because of the difficulty of importing fabric or garments into India, Benetton imported no product. Everything for the Indian market was manufactured there. On the other hand, no Indian production had been exported. India represented about 0.5% of the pieces sold by Benetton throughout the world in 1993.

Benetton was currently searching for a partner in China, having decided to create a "stage five" partnership selling, manufacturing, and eventually exporting products made there. Already, five stores had been opened there to sell a combination of locally-manufactured and imported items, and eight agency territories had been identified to speed the development of a market that Benetton estimated contained 300 million prospective consumers (out of a population of more than a billion), more than triple the size of the target market in the United States. It was estimated that in time Chinese factories could be producing as many as 10 million pieces annually, or roughly 15% of Benetton's total current production. However this would require stepped-up activity from the Group's production in China of 400,000 pieces for the current season, half of what was projected for the following season. This production, all cotton products in which China offered an advantage, was achieved at 30% to 40% lower costs than in Italy. It was thought that most efficient production in China would require a plant of 4 million pieces capacity, much larger than those of Benetton's contractors in Italy. Even so, to get the best costs and quality, Benetton's managers would have to work directly with the factory, unlike methods of working with contractors in Italy. The potential problems of sourcing other countries from China would be the need for longer lead times and loss of flexibility in meeting rapidly changing demands on the factory.

Rather than invest money in licensees and the support of retail shops in a market suffering current difficulties, those holding this view argued that Benetton should invest it in less risky activities about which it knew much more, global manufacturing capability. Only when the Group completed its global network would it be able to compete more effectively with regional competitors in all markets. This, it was argued, was Benetton's true long-term competitive advantage that would be hard for others not operating extensive retail chains in these countries to match. While Luciano Benetton generally agreed with the elements of a longer-term global strategy, he was concerned about the importance of the loss of the "Made in Italy" label in markets outside China for products exported from there. His brother Carlo was concerned that the production of an increasing proportion of Benetton's product outside Italy represented a real risk of loss of control over quality and costs.

The "Made in Italy" manufacturing strategy required that Benetton invest heavily in new technology in company-owned Italian factories to achieve lower costs for the same high quality of output. Because of price pressures, an 8% increase in the Group's unit sales in 1994 was yielding only a 2% increase in lira sales. To support average price reductions of 8% in Italy and 13% in other markets, the achievement of lower production costs in Italy was critical to the Group's future success. To achieve this, Benetton was in the process of investing 200 billion lira (about $125 million) over a three-year period in a new manufacturing complex located near its Ponzano headquarters with a total capacity (in combination with work done by subcontractors) of 40 million cotton garments and 20 million tailored garments annually, roughly 3/4 of Benetton's global capacity. In addition, the number of items in the collection was being reduced.

Everyone agreed that the Group's scarce resource was not and had not been money. The Group had been able to attract capital from partners early in its development and was currently able to finance its growth out of earnings, with free cashflow in the preceding three years sufficient to provide 395 billion lira in new working capital, pay 215 billion in taxes, cover 195 billion in net new investment, pay 198 billion in dividends, and still yield a surplus of 83 billion.

Instead, the scarce resource was time and expertise in dealing with various of the initiatives under consideration. Many of Benetton's senior management team, including Luciano Benetton, travelled internationally on business more than half the time. The August shut-down of the Group's operations would give Benetton an opportunity to once again review the arguments concerning the development of the global network. It would also provide an opportunity to participate more actively in the planning of Fabrica, a new arts and communication research center that the Benetton Group had established in a villa near its headquarters to attract outstanding students in a variety of commercial arts from all over the world who would be expected to point the way for global design and communication into the twenty-first century.

Exhibit 1 Selected Data, The Benetton Group, 1983-1993[a]

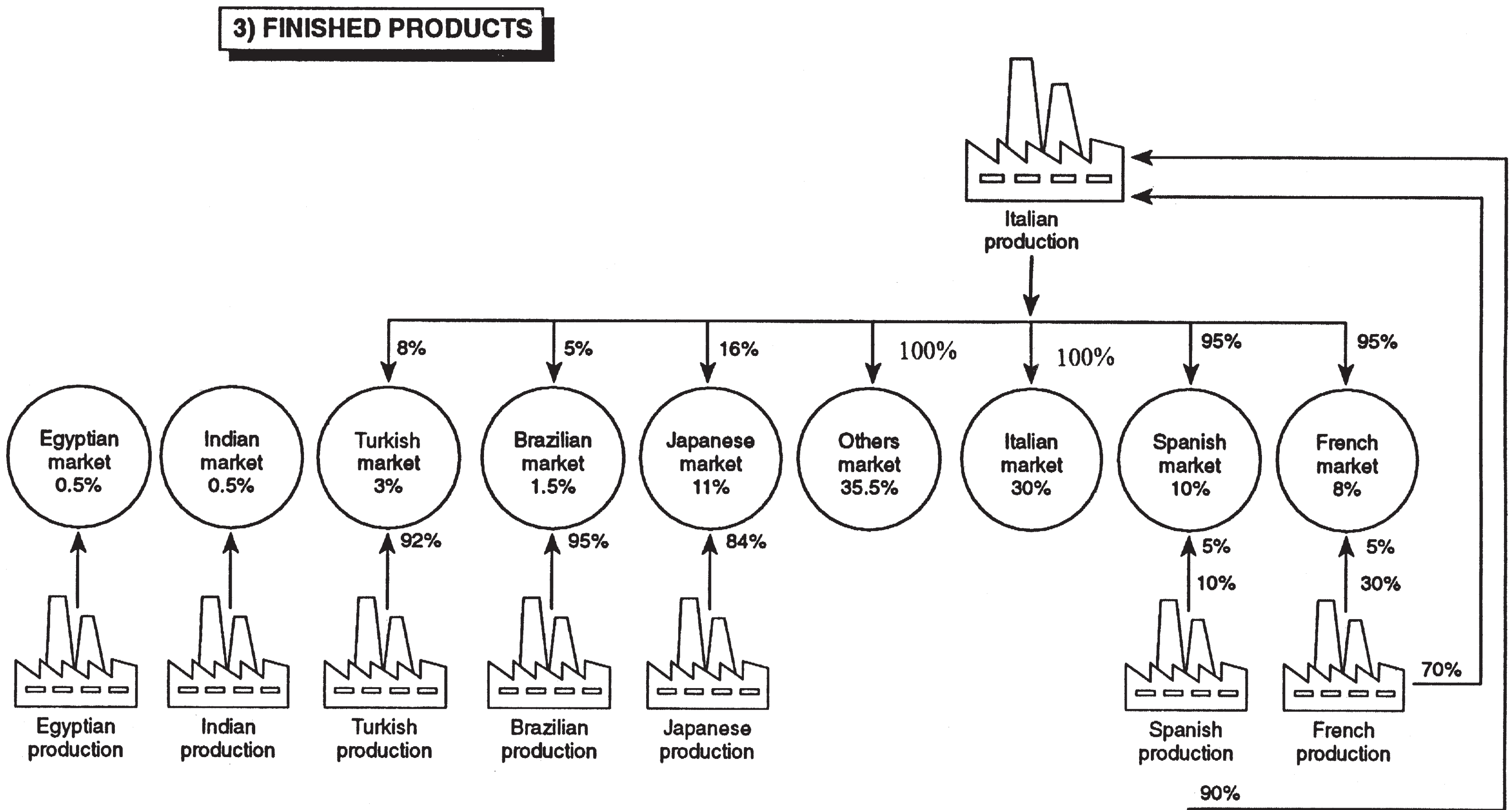
	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993
Worldwide sales[b]	559,816	711,323	874,051	1,067,396	1,234,659	1,446,376	1,625,431	2,034,028	2,303,764	2,512,641	2,751,458
Worldwide profit	13,230	37,180	96,197	113,029	130,291	130,171	115,412	133,271	164,783	184,709	208,038
Total assets	476,456	525,644	591,813	988,807	1,189,349	1,579,372	2,068,745	1,956,101	2,226,994	2,817,768	3,394,019
Total equity	116,591	137,091	197,750	363,996	422,020	470,456	648,497	635,050	781,300	990,382	1,127,284
Employees	1,565	1,504	1,446	1,757	2,033	3,180	3,134	3,282	3,718	5,818	5,895
Lira: dollar ratio[c]											

[a]All monetary figures are stated in millions of lira, unless indicated otherwise.

[b]Sales are at factory level; for roughly comparable sales at retail, these figures should be doubled.

[c]Appropriate average for the calendar year.

Exhibit 2 Flows of Finished Product for the Benetton Group's Core Apparel Products, 1992[a]



[a] Not including products such as shoes, cosmetics, and accessories.

Exhibit 3 The Benetton Group Organization, July 1994

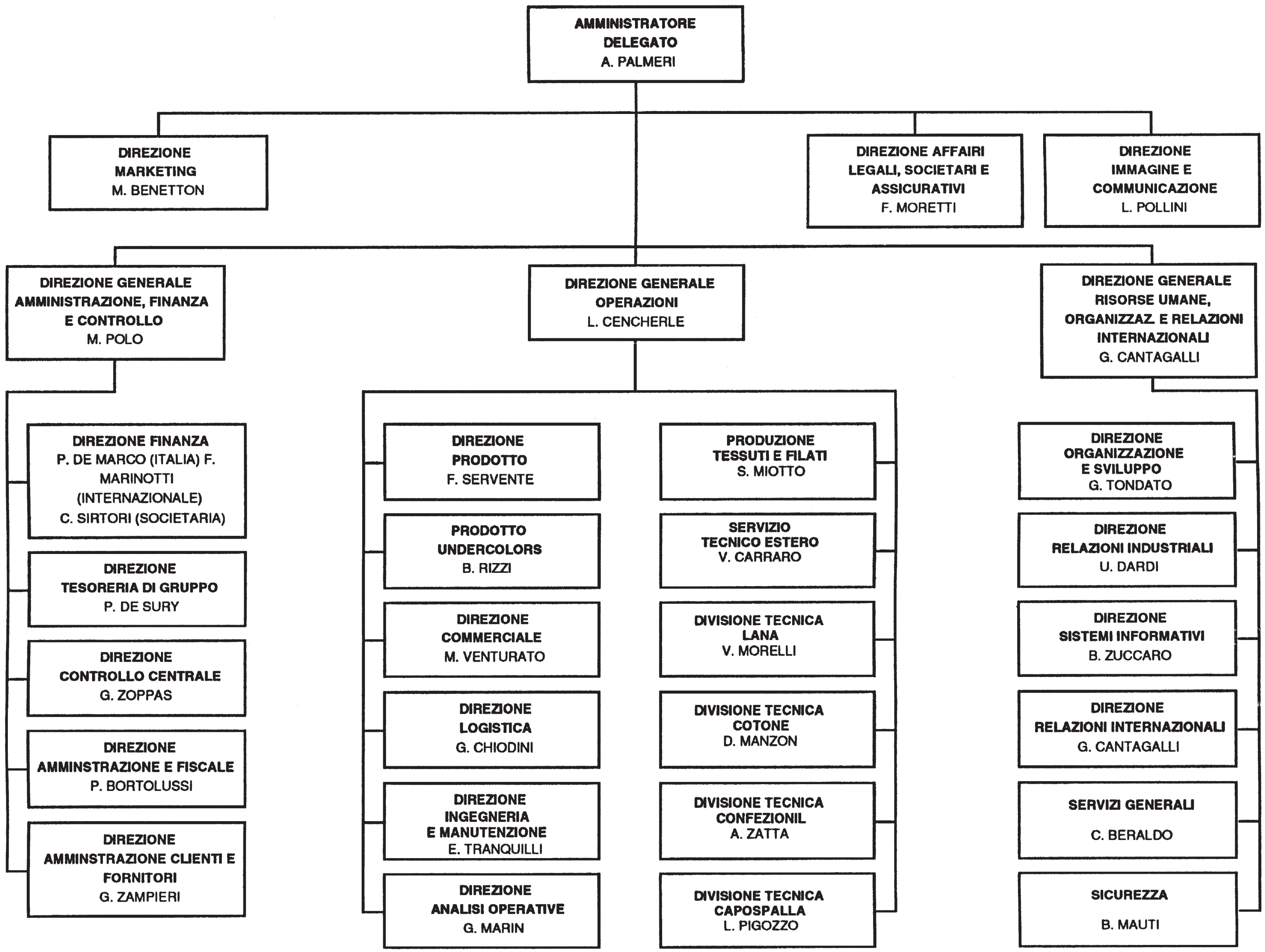


Exhibit 4 Trends in Store Numbers by Region of the World, Benetton Group, 1983-1993

	1983	1985	1987	1989[a]		1991[a]	1993[a]
Europe							
Italy	1,227	1,279	1,470	1,472	(1,601)	1,592	1,607
Germany	233	351	457	469	(532)	555	630
France	387	445	644	565	(665)	563	510
Spain	19	94	151	231	(249)	294	326
G. Britain	63	195	285	211	(247)	238	216
Other	251	344	657	631	(696)	715	844
Total, Europe	**2,180**	**2,708**	**3,664**	**3,579**	**(3,990)**	**3,957**	**4,133**
Africa and Middle East	**---**	**---**	**25**	**82**	**(81)**	**103**	**128**
Asia and Australia							
Far East[b]	---	---	35	67	(157)	128	211
Japan	---	---	78	375	(375)	495	649
Turkey	N.A.	N.A.	N.A.	50	(N.A.)	73	132
South Korea	---	---	---	48	(N.A.)	57	98
Other	---	---	---	29	(54)	72	80
Total, Asia and Australia	**---**	**---**	**113**	**569**	**(532)**	**825**	**1,170**
South America	**---**	**---**	**229**	**334**	**(387)**	**230**	**295**
North America							
U.S.[c]	66	399	796	706	(713)	533	265
Mexico	---	5	25	62	(43)	68	82
Canada	5	28	73	51	(58)	66	40
Total, North America	**71**	**432**	**894**	**819**	**(814)**	**667**	**387**
Other[d]	**45**	**62**	**70**	**---**	**(51)**	**---**	**---**
Total	**2,296**	**3,202**	**4,995**	**5,383**	**(5,855)**	**5,782**	**6,113[e]**

[a] Beginning in 1989, the basis for store counts was changed; for 1989, the store counts by the method used for years prior to 1989 are shown in parentheses.

[b] Includes Taiwan, China, India, and Southeast Asian countries.

[c] Includes stores in the Caribbean

[d] Unidentified by country.

[e] These stores represented 8,509 "points of sale" for separate lines of Benetton merchandise, with some stores offering two or more of the Benetton, Sisley, or 012 lines of merchandise.

Exhibit 5 Comparative Profit Models, Benetton Group and Selected Apparel Manufacturers and Retailers, 1993

	Company			
Item	**Benetton**	**The Limited**	**The Gap**	**Nike**
Sales	L2,752[a]	$7,245[b]	$3,296[b]	$3,931[c]
Profit	L208	$391	$258	$365
Assets	L1, 556[d]	$4,135	$1,763	$2,188
Equity	L1,127	$2,441	$1,127	$1,646
Employees	5,895	97,500	44,000	9,600
Profit/Sales	7.6%	5.4%	7.8%	9.3%
Sales/Assets	1.77 (2.13)[f]	1.75	1.87	1.80
Assets/Equity	1.38 (1.5)[f]	1.69	1.56	1.33
Profit/Equity	18.5%	16.0%	22.9%	22.2%
Sales/Employee	$291,800[e]	$74,300	$74,900	$409,500

[a]Stated in billions of lira; equivalent to about $1.7 billion; for comparability with retail sales of The Limited and The Gap, this figure should be doubled.

[b]Stated in millions of dollars.

[c]Stated in millions of dollars for the fiscal year ending May 1993.

[d]Net capital employed, defined as current net assets (gross current assets less current debits) plus net investments plus multiannual charges plus start-up charges minus medium- and long-term passive funds (guaranteed loans plus nonguaranteed loans plus employees' pension fund plus tax fund plus currency fluctuation fund).

[e]Employees and sales/employees represent those for the core group of Benetton operations associated with the 2,752 billion lira of sales, with sales / employees connected to dollars at the rate of 1,600 lira to the dollar.

[f]Ratios in parentheses exclude L264 billion added to fixed assets in an intra-company transaction in 1992.

Exhibit 6 Pieces Sold and Revenue Realized at Factory Level, Core Products, Benetton Group, 1989-1994[a]

Millions of Pieces Sold

Year	Europe	Asia	North America	Other	Total
1989	41.4	2.4	8.5	.5	52.8
1990	45.4	3.6	8.2	.8	58.0
1991	48.0	3.9	7.0	1.0	59.9
1992	48.8	3.7	5.3	1.7	59.5
1993	47.6	3.4	4.2	1.9	57.1
1994[b]	51.2	6.7	4.3	2.7	64.9

Revenue[c] (in billions of lira)

Year	Europe	Asia	North America	Other	Total
1989	1,062.9	52.8	148.2	9.4	1,273.3
1990	1,254.2	92.6	173.4	15.8	1,536.0
1991	1,357.5	94.4	142.2	23.5	1,617.6
1992	1,454.7	92.2	114.8	35.7	1,697.4
1993	1,443.8	111.1	96.5	45.8	1,697.2
1994[b]	1,438.0	190.0	100.0	59.9	1,787.9

[a]Data includes only the "core" Benetton fashion apparel (Grupo Ristretto), excluding related items such as shoes, cosmetics, and accessories; data does not include products produced by contractors and partners in Brazil, Argentina, Japan, Turkey, and India for sale in local markets.

[b]Figures for 1994 are prospective and from The Group's plan; Asian figures for 1994 were inflated by a decision to relocate much of the production in Japan (not included in the statistics) back to Italy.

[c]Revenue is calculated on the basis of exchange rates fixed at the beginning of each season for wholesale pricing purposes.

Exhibit 7 Proportion of Invoiced Value of Factory Shipments, by Country, Benetton "Core" Products, 1990-1993[a]

Country or Region	1990		1991		1992		1993	
	Proportion of Total Invoiced Value of Core Products Shipped[b]							
Europe								
Italy	32.4%	(82.1)[c]	30.8%	(76.5)[c]	31.7%	(74.5)[c]	28.3%	(68.6)[c]
Germany	11.5		12.2		12.8		12.0	
France[c]	9.2	(.9)	7.3	(.8)	7.9	(1.3)	6.9	(5.6)
Spain[d]	4.7	(3.1)	4.5	(4.8)	5.4	(5.4)	5.2	(4.9)
United Kingdom	4.5	(.2)	4.1	(1.0)	4.0	(.8)	3.3	(.6)
Other	11.7		11.7		12.6		11.9	
Total	74.0%		70.6%		74.4%		67.6%	
Rest of World								
United States	9.3%	(2.4)	6.3%	(1.4)	4.6%	(.8)	3.5%	(.4)
Japan	12.2	(9.6)	14.7	(12.6)	13.1	(11.1)	15.3	(12.8)
Other	4.5	(1.6)	8.4	(2.9)	7.9	(6.0)	13.6	(7.0)
Total	26.0	(13.6)	29.4	(16.9)	25.6	(17.9)	32.4	(20.2)
Total World	100.0	(100.0)	100.0	(100.0)	100.0	(100.0)	100.0	(100.0)
Portion of "Core" to Total Benetton Invoiced Product Value[f]	N.A.		84.9%		80.9%		79.0%	

[a] "Core" Benetton products are apparel items exclusive of shoes, cosmetics, accessories and other products.

[b] Because amounts are credited at the time of shipment on products that are not paid for until several months later, these figures do not correspond to sales.

[c] Numbers in parentheses are the shares of the invoiced value of all Benetton shipments produced in the country. Thus, of all products shipped for sale in France in 1990, about 10% (.9/9.2) were produced there.

[d] In 1991, Spain was a net exporter of product, by value.

[e] Because of a small amount of product shipped to Italy from other countries, this does not exactly equal Italian production. Because of a decision to relocate much of the Japanese production back to lower-cost Italian factories, this figure was expected to rise in 1994.

[f] "Non-core" products included shirts, shoes, cosmetics, underwear, stockings, advertising revenues from Benetton's Formula One racing team, and others.

Exhibit 8 Trends in Benetton's Japan Business, 1986-1994[a]

Year	Stores in Operation at Year End	Sales of Goods Imported from Italy (L billions)	Invoiced Value of Goods Produced in Japan (L billions)[b]	Average Price per Piece (in lira)[c]
1985	NA	.7[d]	0	NA
1986	47	.0	NA	NA
1987	78	.2[d]	NA	NA
1988	205	9.6[d]	NA	NA
1989	375	35.4	NA	22,620
1990	432	44.4	162.2	26,490
1991	521	40.8	241.7	28,020
1992	537	39.1	217.5	28,590
1993	649	51.2	274.1	35,470
1994[e]	NA	91.5	NA	NA

[a]Sales and invoice figures are for Benetton's "core" product line of Benetton, Sisley, and 012 apparel only and do not include cosmetics, shoes, and accessories.

[b]Several months elapsed between a Benetton invoice and the receipt of payment from stores. As a result, the value of invoices (in lira at the time of issuance of the invoice) was not equal to sales.

[c]Benetton's prices to retailers.

[d]These figures represent the value of invoices rather than sales.

[e]The volume of product shipped from Italy was expected to increase because of the shift of significant amounts of production in Japan to lower-cost factories in Italy.

Exhibit 9 A 1984 Benetton Advertisement

Exhibit 10 A 1991 Benetton Advertisement

Exhibit 11 Trends in Benetton's U.S. Business, 1983-1994[a]

Year	Stores in Operation at Year End	Sales of Goods Imported from Italy (L billions)	Invoiced Value of Goods Produced in the United States (L billions)[b]	Average Price per Piece (in lira)[c]	Operating Profit to Benetton (L billions)
1983	66	13.9[d]	0	NA	NA
1984	190	50.5[d]	0	NA	NA
1985	399	116.7[d]	NA[e]	NA	NA
1986	640	154.1[d]	NA	NA	16.0
1987	796	139.1[d]	NA	NA	9.0
1988	803	111.4[d]	NA	NA	16.0
1989	706	135.8	NA	17,400	(1.0)
1990	701	157.2	41.2	21,380	(8.0)
1991	533	120.2	27.8	20,360	(12.0)
1992	363	90.1	16.5	21,440	(12.0)
1993	265	74.2	9.6	22,810	(22.0)
1994	150	78.4	0	22,980	0

[a]Sales and invoice figures are for Benetton's "core" product line of Benetton, Sisley, and 012 apparel only and do not include cosmetics, shoes, and accessories.
[b]Several months elapsed between a Benetton invoice and the receipt of payment from stores. As a result, the value of invoices (in lira at the time of issuance of the invoice) was not equal to sales.
[c]Benetton's prices to retailers.
[d]These figures represent the value of invoices rather than sales.
[e]The U.S. plant was opened in 1985 and closed in 1993.