

e-Commerce Fulfillment Strategy for Luxury Brands in South Korea

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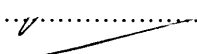
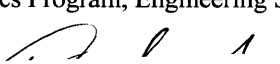
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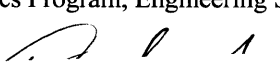

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
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1. INTRODUCTION AND MOTIVATION

From a traditional paradigm, the term “luxury e-commerce” is an oxymoron. The high-volume, hands-off approach of online sales is a direct contradiction to that of the high touch, human relationship-based luxury retail industry. It is for this reason that, until recently, many luxury brands have avoided e-retail - the belief is that it cheapens their image (Okonkwo, 2010). However, the successful experiences of certain companies in specific regions are gradually giving many luxury retailers a reason to reconsider e-commerce. For example, the luxury retailer Ralph Lauren has experienced huge success in e-commerce (see Figure 1), and is on a mission to proliferate their multi-channel sales model across the globe. South Korea is one of the most recent locations in which Ralph Lauren has chosen to roll out an e-retail initiative.

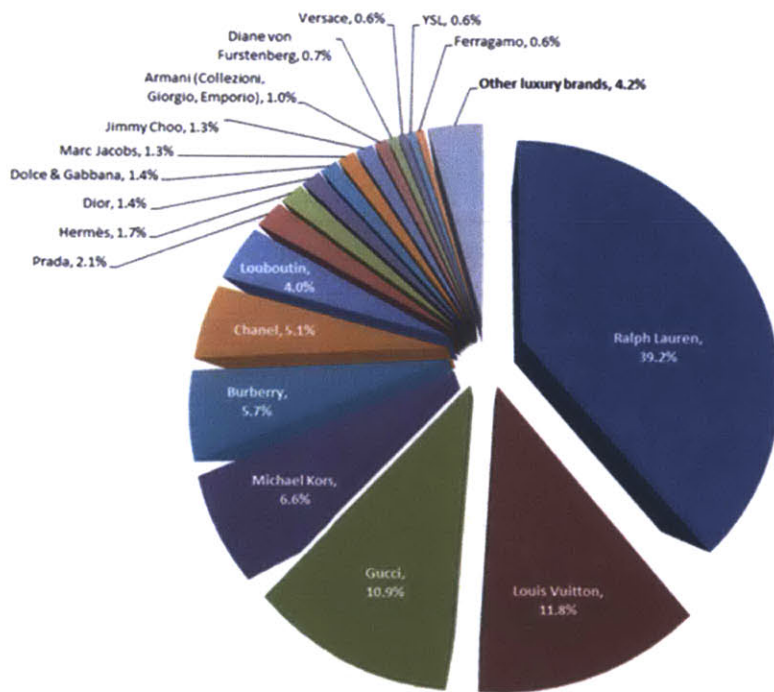


Figure 1: Worldwide e-Commerce Market Share (PM Digital Research, 2011)

Explosive economic growth across Asia has rapidly expanded the market for luxury goods and services. In South Korea, this growth has been particularly strong and consistent, as has South

Korean consumers' appetite for luxury. This strong market growth, confluent with the reputation as the world's most wired country, makes South Korea an attractive target for e-commerce implementation.

The Ralph Lauren team came to us with a rather broad request: to help them investigate the potential challenges of their e-retail initiative in South Korea. Through our research, we found several interesting and pertinent optimization models that could be modified to plan for Ralph Lauren's e-retail operation in South Korea, but as we delved into these models we realized that they didn't address Ralph Lauren's paramount mission in Korea, which is to "elevate the brand". We took a step back and zeroed in on our focus question: how could Ralph Lauren elevate its brand while simultaneously launching an e-commerce initiative in South Korea?

We believe the insights gained from our study will help Ralph Lauren utilize "systems-thinking" to make strategic and operational decisions in South Korea that can elevate their brand image. These insights might also apply to other luxury retailers considering an e-commerce initiative in South Korea or other countries. This thesis presents several thought models that incorporate factors like inventory policy, brand strength, mediation, customization and online sales mix – which may make this research of interest to sales, marketing, operations and supply chain professionals.

1.1 Ralph Lauren – Our Sponsor Company

Ralph Lauren Corporation is a luxury clothing and goods company founded by the American fashion designer Ralph Lauren. Ralph Lauren specializes in high-fashion luxury clothing for men and women as well as accessories, fragrances, bedding, towels, and housewares. It has its

headquarters in Midtown Manhattan, New York City. Ralph Lauren is a CTL partner with the MIT Supply Chain Exchange.

In 1967 Ralph Lauren launched its first brand, Polo. From a selection of neck-ties, the company has expanded to include a variety of brands for men, women, children and babies. The men's line comprises the higher-end brands Purple Label and Black Label, as well as Polo Ralph Lauren, RLX, RRL, Denim & Supply, Golf, and Rugby. The women's line ranges from the higher-end brands Collection and Black Label to Blue Label, RLX, Lauren, Denim & Supply, Golf, and Rugby. In addition, Ralph Lauren owns the Club Monaco brand and has children's and baby merchandise lines. Figure 2 represents the hierarchy of brand labels within Ralph Lauren.



Figure 2: Product Line Hierarchy for Ralph Lauren

Because Ralph Lauren operates a diverse range of clothing lines, the company has the ability to move between various target markets and pricing levels, such as the high end, middle tier, sport,

and specialty segments. The expanding wealth of the South Korean market presents an opportunity to expand the high-margin, high quality luxury lifestyle collections, such as the Purple and Black (“Collection”) labels. One specific goal is to expand their offering of accessories such as belts, handbags and jewelry. Throughout this thesis, we refer broadly to “Blue Label” and “Collection” as the representative lower and upper tiers of their product segments for both men and women. In addition, we use “Ralph Lauren” interchangeably to represent both Ralph Lauren Corporation and the Ralph Lauren brand.

1.2 Luxury in South Korea

According to the Korea National Tax Service, there are nearly 20 million Koreans who have annual salaries of more than 100 million Won (the South Korean currency – equal to about US \$90,000), which qualifies them as “high income workers.” In addition, more than 80% of Koreans are internet users. The results of a 2010 survey from McKinsey & Co show that 35-45% of respondents are increasing their online purchases of luxury goods. (Salsberg, 2010)

Given the economic strength of South Korea as a nation, and the budding luxury consumer base, Ralph Lauren is looking to establish an e-commerce capability as they continue to grow their retail business as a whole.

International operations are a key priority for Ralph Lauren Corporation’s strategy because most of its international business is done via full-price sell through stores such as Ralph Lauren, Club Monaco and Rugby stores. These brand stores fetch higher margins than the concession retail stores (such as Macy’s) typical of the U.S. market. The increase in retail business, particularly in Asia, was one reason that Ralph Lauren posted a healthy growth in gross margin, despite the overall apparel industry’s struggle to combat rising production costs.

Coming into the global recession after several decades of explosive growth, South Korea has positioned itself as the 15th largest economy in the world, and the seventh largest trading partner with the U.S. (U.S. Department of State, 2012). The recession slowed GDP growth to 0.2% as of 2009, but South Korea is already rebounding – in 2011 GDP growth was strong at 3.6% (EIU, 2012). South Korea consistently ranks at the top of “most wired countries” in the world, and recently, a free trade agreement with the U.S. (“KORUS”) was approved – economists project that billions of dollars will be generated in both countries. South Korea’s labor force is more than 24 million strong, with nearly 70% of that in the services industry (U.S. Department of State, 2012). This high degree of service industry employment reflects a white collar market. The potential for wealthy and aspiring consumers to see value in a luxury lifestyle company like Ralph Lauren is ever-growing.

In the luxury market, South Korea represents 4% of global sales; it accounts for 15% of all fashion spending (4 billion dollars) – but interestingly, most of the growth in luxury goods is not in fashion apparel, which has remained relatively flat since 2009 (Salsberg, 2010). Other luxury categories such as watches, bags and shoes saw the most growth in 2009 (10% to 30% for some brands). The potential for e-retail to continue growing in South Korea, especially in luxury goods and lifestyle brands, rests on a range of factors. Those factors include: a growing number of wealthy and aspiring wealthy individuals, a culture that is generally more geared toward luxury spending, and a change in the demographic of luxury shoppers – 20-30 year olds now make up 44% of luxury shoppers, up from 35% in 2006 (Salsberg, 2010). Younger people may be more accepting of e-retail, but the challenges of authenticity, inability to see and touch the product before buying (called “mediation”), and differences in after sales service remain. A successful e-

retail strategy will be able to address the concerns of the consumers and tap into this growing source of revenue.

1.3 Elevating the Brand

What is “brand image”? According to Kim, 2010, a brand’s “value” is a very subjective concept that consists of four parts: “Expressive or social value...utilitarian value...emotional value...[and] economic value” (M. Kim, S. Kim, & Lee, 2010). A company’s brand is their face in the public’s eye – it is built over time and with careful attention to customer satisfaction.

Until recently, Ralph Lauren’s presence in South Korea was fully managed by its licensee, the Doosan Corporation. For years, Doosan harvested the brand’s value by pursuing a high-volume, Blue Label-centric sales strategy. This is a common practice for license holders – they want to make the most out of their investment without necessarily having to spend money on functions such as brand management or market research. Doosan negotiated relationships with powerful department stores and together they dictated the operational details that best served their purposes. Department stores typically managed the physical retail operation. As a result, most of Ralph Lauren’s shelf space in a given department store had been loaded with middle and lower tier Blue Label garb – the mesh Polo shirts and Chino khakis for example. These are the classic products that Ralph Lauren has built its success on – and these are the types of products that license holders push to their customers. Doosan may have further pushed sales of these Blue Label items by utilizing commodity-merchandising techniques such as discounting. Due to Doosan’s harvesting strategy, the Ralph Lauren brand image is fairly diluted in South Korea.

One of the powerful department stores that Doosan negotiated business with was Shinsegae, owned by the Samsung Group. Both Shinsegae and Samsung are referred to as “Chaebols” (chā-bōls) – or large family run conglomerates typical of South Korea. These Chaebols have a long-standing tradition of growth, patriotism and contribution to the Korean economy, and they often encourage other Chaebols to succeed as well, if it means helping the country. Shinsegae, in a patriotic effort to create its own domestic line of casual clothing, formed the brand Bean Pole. An illustrative phrase among South Korean Chaebols that represents their patriotic sentiment is “anything they can do, we can do just as well” – thus Bean Pole looks and feels strikingly similar to Ralph Lauren’s Polo (Blue Label). Over the past decade, Shinsegae strategically placed each one of its Bean Pole retailers in close vicinity to a Polo retailer within the department store. This practice elevated Bean Pole’s image while further diluting the Ralph Lauren image, and now they are seen as direct competitors.

Globally, Ralph Lauren projects itself as an upper-tier luxury brand and it wants to project that same image in South Korea. Ralph Lauren would prefer to be seen as a competitor of Louis Vuitton or Gucci, for example, rather than Bean Pole. In an effort to gain better strategic control of its brand positioning in South Korea, Ralph Lauren recently bought back the license that it granted to Doosan Corporation a decade ago. Within South Korea, Ralph Lauren now has direct control of its fulfillment center and 180 retail stores – and it is on a mission to elevate the brand.

To do so, Ralph Lauren will have to carefully manage the mix of labels offered in each department store, as well as vie for appropriate space in the department store. Changing the South Korean consumer’s perception of Ralph Lauren is challenging enough on its own, but at the same time, Ralph Lauren plans to launch its e-commerce initiative in South Korea – the second e-commerce launch on the continent (after Japan). Ralph Lauren sees this dynamic

period as an opportunity to not only elevate the brand, but also enhance operational efficiency, product assortment and service offerings.

1.4 Seeking a Clear Strategy

While there is clearly opportunity in the South Korean market, the question for Ralph Lauren is how to create as memorable and luxurious an experience online as they do in brick-and-mortar retail stores. This often proves easier said than done. Choi (2006) summarizes the difficulties in his paper *Key Factors for e-Commerce Business Success*: “An e-commerce customer faces mediation in every element and at every stage of the commerce transaction. Customers can't see the merchant, but only the merchant's website; they can't touch the merchandise... wander a store... [or] explore the store's shelves... they can only search a digital catalog by browsing web pages.” (Choi, Park, Lee & Ryu, 2006) For Ralph Lauren, introducing e-commerce requires careful strategic thought and intelligent execution because their customers aren't just buying products – they're looking for an experience that indulges every sense.

In addition, Ralph Lauren needs to consider other, less obvious, influences on their brand image – such as the value of a stock-out. In practice, customers will occasionally perceive an item as more desirable if it is less attainable – a concept called scarcity. (M. Kim et al., 2010) For instance, the fashion brand Zara creates product scarcity by only carrying inventory for a few weeks or sometimes days. In these cases, having only a few items on the shelf can cause frenzy of demand among customers. It can also strengthen the brand image and promote future interest and sales opportunities. Other times, when items stock-out, a more traditional customer reaction is seen: they lose interest in the brand and are not inclined to shop again. For this reason, a well thought-out and carefully managed inventory management plan is essential for Ralph Lauren.

Traditionally, improving services has always been associated with improving customer experience and thus improving brand image: customers want to feel special and important. Ralph Lauren can leverage relationship building tools such as “black car services,” exclusive memberships, and priority, VIP treatment to differentiate themselves and give customers that feeling of importance. However, augmenting “services” is different from augmenting “service metrics” – increasing a service metric, such as the stock-out rate, can have either a positive or negative effect on the brand. The suggestion that service metric failures can potentially elevate the brand raises some interesting questions for Ralph Lauren as they introduce e-retail in South Korea.

1.5 Project Scope

This project aims to help Ralph Lauren enhance their brand while simultaneously launching an e-commerce initiative in South Korea. Specifically, we wish to identify critical decision-points in the areas of inventory policy, e-commerce implementation, and value-added services. We turned to systems-thinking to help us define these decision-points.

Systems-thinking challenged us to delve into Ralph Lauren’s South Korean operation and explore how different factors interact over time to affect its brand image. It is a multi-step process that helped us zero in on the strategic variables involved, and define the business policies that would affect those variables. We started by asking questions about the nature of “brand image” in relation to Ralph Lauren’s multi-channel operation. The questions we began with included: What factors contribute to a brand’s image? How could Ralph Lauren create luxury experiences that enhance their image, both in-store and online? How could Ralph Lauren leverage their inventory to manage their brand?

These questions can be represented by system dynamics models to show the interactions between different operational factors, demand factors and the brand image. Strategic framework analysis helped us bridge our system thinking into Ralph Lauren's specific situation – we used SWOT Analysis and Porter's Five Forces to analyze both the e-luxury industry in South Korea, as well as Ralph Lauren's position as it enters that industry.

Aligning Ralph Lauren's strategic position with the implied system behaviors raised by our questions allowed us to postulate answers and prescriptive actions the company can take to elevate the brand while introducing e-luxury in South Korea. Throughout this thesis we will suggest several ways that Ralph Lauren can use an omni-channel operation to differentiate its services to Korean customers and elevate its brand image. Ultimately, Ralph Lauren's business performance relies on their brand image, and we seek a better way to define what combination of services and operations can elevate that image.

We believe the most influential and practical takeaways from this research are the strategic variables that help elevate a luxury brand's image when e-retail is implemented. In addition, the questions we raised and thought models we employed to reach these takeaways may provide management with a new perspective on how to approach e-retail for luxury goods in the future. While the questions, variables and thought models we produce may be applicable in other countries, this research is specifically limited to omni-channel luxury retail in South Korea, and will not extend into China, Japan, or other parts of Asia.

1.6 Thesis Structure

The remainder of this thesis is structured as follows: Chapter 2 brings together the current status and research over-arching the South Korean market, luxury retail, and e-retail – so that we may

build upon analyses done by previous researchers; Chapter 3 will define our methodology for approaching this thesis; Chapters 4, 5 and 6 comprise the bulk of our data gathered from site visits, strategic analysis and system dynamics modeling; Chapter 7 contains a discussion and analysis of Ralph Lauren's e-retail strategy, including prescriptive operational measures that we recommend; Chapter 8 summarizes and concludes our thesis. References and supporting material follow the Conclusion.

2. LITERATURE REVIEW

Ralph Lauren is seeking guidance on how to move forward with their e-commerce business in South Korea – elevating the brand while simultaneously growing sales. Through our research, we have discovered ample literature on e-commerce, luxury retailing and the South Korean business environment. We have also discovered some literature pertaining specifically to the integration of e-commerce with a traditional brick-and-mortar operation. However, there is very little academic research into online luxury retail in South Korea, a very unique country where high technology infrastructure contrasts sharply with the traditional retail channel. Therefore, the purpose of this review is to bring together the available information from those three existing pillars of research: South Korea, luxury retail, and e-retail. We build upon the three pillars to provide a more accurate picture of what Ralph Lauren, or any Luxury retailer in South Korea, might encounter while pursuing e-commerce integration.

2.1 What’s Going on in South Korea?

In a word: growth. The South Korean economy seems to be oblivious to that of the U.S. and the Euro zone, who are struggling to avoid an economic meltdown. The Economic Intelligence Unit points out a real GDP growth rate of 3.6% in 2011 and an expected growth rate of 3.2% in 2012. (EIU, 2012) Driving this growth is a motivated and educated local workforce, competitive wages, and the relatively new practice of at-will employment, which gives employers and employees the freedom to switch jobs easily. Previously, powerful trade unions mandated that lifetime employment was the norm; this is becoming less and less common as South Korea shifts toward a market economy. The Labor Standards Act of 2003 brought even more Western practices to South Korea – including a 40 hour work week spanning Monday through Friday.

Average monthly wages for non-farm industries and companies employing more than 5 people in the first quarter of 2011 were at nearly \$2,580 (up from \$2,465 the same quarter last year). (EIU, 2011) Higher wages leads to disposable income, and increasingly wealthy South Koreans are spending their money on imported goods. In addition, the rapid recovery from the financial crisis of 1997 gave South Korea even greater spending power on imported goods – especially Luxury goods. (Hye-Jung Park, Rabolt, & Kyung, 2008)

While luxury sales in Japan, Europe and the U.S. are stagnating, South Korea's rose 12% in 2010 to \$4.5 billion. (A. Kim, 2011) South Korea now accounts for over 4% of global luxury goods consumption; "it is also becoming part of the fabric of Korean life." (Salsberg, 2010) The number of Luxury brands has increased dramatically over the last 10 years, increasing competition and changing customer behaviors. Research by McKinsey & Company in both 2010 and 2011 indicates that "the persistent strength in the South Korean Luxury market is driven by two important 'soft' factors: a love of luxury and peer pressure." (Salsberg, 2010)

To the chagrin of some Western nations who promote free and open markets, a big portion of South Korea's growth still derives from the country's Chaebols. Chaebols are the family run conglomerates unique to South Korea, and have been critical to the nation's growth over the last seventy years. For example, the top 30 Chaebols were responsible for nearly 30% of South Korea's GDP by 1989. The top 30 Chaebols in 1997 (prior to the Asian financial crisis) accounted for almost half of South Korea's corporate sector. (Asian Development Bank, 2001) Attempts to restructure and reform the Chaebols (and drive toward a more market driven economy in general) have had some success. In the wake of the financial crisis of 1997 for example, the IMF bailout for South Korea was an impetus for other nations to demand greater regulation of the market. Among other things, this meant the Chaebols had to provide more

transparency, greater concentration on a single core business, and greater accountability toward shareholders. Several aspects of the new KORUS free trade agreement (the FTA between the U.S. and Korea) are also aimed at curbing the power of the Chaebols and allowing foreign competition to enter the market, in addition to protecting foreign intellectual property rights. (Cooper & Manyin, 2007)

For many South Korean entrepreneurs, the mentality towards foreign competitors is: “anything they can do, we can do just as well” – Koreans like to see and support local winners. While touring several department stores in Seoul, a consulting manager for Ralph Lauren’s Korea operations explained to us how copyright infringement is sometimes blatantly obvious to Westerners, but since there are fundamental cultural differences regarding brands and originality, litigation is usually not a feasible option. He presented the case of Bean Pole – a purportedly high-end retailer owned by Samsung Group – whose merchandise and even logo looks strikingly similar to Ralph Lauren’s. (Stylianou, 2011) However, we still find that “consumer ethnocentrism” is not a limiting factor for international luxury brands in South Korea. Customers are seeking well-known brands that symbolize prosperity and a material lifestyle – whether they are local or global. (Hye-Jung Park et al., 2008)

Our interviews with Korean consumers and luxury store managers indicate that “parallel imports” (also called “grey market” merchandise) are also common. (Y. R. Choi, 2011) Parallel imports refer to the selling of goods “outside of their authorized channels of trade.” (Espinosa, 2007) They exist in South Korea because the price of a Polo shirt in Seoul, for example, is significantly higher than a similar Polo shirt in the U.S. – so businessmen in Seoul will seek out bulk purchases in the U.S. which are then sold at a discount in Seoul. While technically legal in South Korea, brand owners like Ralph Lauren believe that the existence of grey markets

undermines their ability to control quality and image. In addition, brand owners can experience significant sales loss, as the parallel imports are often priced 30-50% less than the same merchandise in department and specialty stores. (Espinosa, 2007)

Chaebols such as The Samsung Group can present a challenge to foreign brands – they often own a large portion of the supply chain, and have complex relationships with other Chaebols, leaving companies like Ralph Lauren at the mercy of their local masters. In South Korea, Ralph Lauren had previously licensed out its brand to the Doosan Corporation. Doosan then negotiated arrangements with department stores such as Shinsegae to sell Ralph Lauren products. Samsung owns Shinsegae Department Stores, and they had the power to make critical decisions regarding merchandising, store location, and pricing, which affected Ralph Lauren’s image. In addition, Samsung created the Bean Pole brand to compete with Ralph Lauren – and conveniently placed Bean Pole adjacent to Ralph Lauren in all of their Department Stores. (Stylianou, 2011) A Vice President of Supply Chain Integration for Ralph Lauren explained that “the typical licensee incentive is to ‘harvest’ the brand, rather than invest in it.” (Rush, 2011) To exacerbate the situation, Samsung split off a food, chemical and entertainment subsidiary in the 90s: CJ Group. In November 2011, CJ Group said they would acquire a 40% stake in Korea Express, the largest logistics firm in Korea. Essentially, Samsung would then have a vertically integrated supply chain whose terminus is the largest department store in the world – Shinsegae. (CJ to Acquire 40% Stake, 2011) Foreign retailers who want to break into e-commerce will possibly have to fight for a share of Korea Express’ services against Samsung-owned brands such as Bean Pole.

2.2 South Korea's Obsession with Luxury

“Luxury brands are those whose ratio of functional utility to price is low while the ratio of intangible and situational utility to price is high.” (Nueno & Quelch, 1998) Different consumers of luxury goods have different values of “intangible and situational utility” but generalizing the tendencies of a particular culture can allow luxury brands to refine their strategy and tailor it to a region. In a 2010 study in the *Journal of Retailing and Consumer Services*, authors Kim, Kim, and Lee examined how South Korean customers value foreign luxury brands and how they respond to different distribution and sales models. They explain that a brand’s “value” is a very subjective concept that consists of four parts: “expressive or social value...utilitarian value...emotional value...[and] economic value” (M. Kim et al., 2010) The researchers tested how adding different distribution channels such as Television Home Shopping (TVHS), e-retail, and outlet stores to a traditional, brick and mortar distribution channel affected the four parts of a luxury brand’s value, and to what extent. Study participants described having “high joy” (an emotional value) when purchasing from traditional distribution channels (TDC). In fact, TDC scored the highest on all brand value components except for economic value (price) – which suggests that luxury retailers should be focused on traditional brick and mortar stores and creating personal relationships with customers first and foremost.

In general, South Koreans are more “luxury friendly” than people in most other developed countries. The 2010 McKinsey study found that “only 5% of customers feel guilty about how much they spend on high-end products, compared to 10-15% in other developed countries. Only 5% of respondents in Korea said that ‘I think buying luxury goods is a waste of money.’”

(Salsberg, 2010) The acceptance of luxury and showing off success stems from a culture of

admiring responsibility and position in society. For example, if your title at work is “manager” it is common to have a personal driver and “black car”. CEOs often have private entrances to their buildings. Exclusivity and luxury have traditionally gone hand-in-hand – and the high prices associated with luxury goods have kept them exclusive. Wealthy consumers in Korea purchased luxury goods both for self-indulgence and as a way to show off their status. People were willing to pay a premium for famous brands with noticeable logos to make sure everyone could recognize them. However, the McKinsey study has uncovered a trend which could be alarming for those famous brands: an increasing number of consumers believe that “owning luxury goods is not as special as it used to be.” Instead, differentiation is the new fashion, and consumers are seeking luxury brands “that help [them] stick out from the crowd.” (A. Kim, 2011)

While it is true that the growth of South Korea’s luxury market is being shouldered mostly by high spending “VIP” customers, an increasing number of young consumers are breaking their way into luxury as well. (Salsberg, 2010) At one particular luxury-oriented department store, Lotte’s Avenue L, the percentage of shoppers who were between the age of 20 and 30 increased from 35 to 44 between 2006 and 2009. (Salsberg, 2010) Typically, these young “wealthy aspirants” are less likely to trade up to higher brands and price points exclusively. However, they do tend to spend more on luxury accessories (such as watches and leather, for instance) while at the same time looking for a competitive deal. (A. Kim, 2011) Our interviews with South Korean luxury customers elaborated on that fact: “Luxury consumers have no problem switching between brands at the lower level if they perceive similar quality for a lower price. The higher end customers, however, are typically repeating customers looking for a unique service experience.” (Y. R. Choi, 2011)

A critical part of luxury shopping is the in-store experience. However, customers in South Korea are often discouraged by the typical lack of assortment in department stores, which have very limited shelf space. (M. Kim et al., 2010) For this reason, many luxury brands are seeking other channels such as TVHS and internet stores to expand their product assortment and availability to customers. (M. Kim et al., 2010) Luxury e-commerce has had flat growth, though – which may be due to customer concern with authenticity, sizing, returns or other services. At the same time, an online presence does appear to be a necessary and expected tool for luxury consumers to evaluate and compare products and have 24-hour access to the store. (M. Kim et al., 2010)

According to the 2011 McKinsey research report, there are 5 priorities that luxury brands should focus on to sustain their growth: innovate and create excitement to stay relevant – a prestigious global brand will no longer guarantee success in South Korea; clarify the brand to differentiate from similar competitors; treat VIP's differently with creative and individually tailored services to build an emotional connection with them; segment the brand into tiers that match a segmented luxury consumer market; invest in e-commerce but be cautious and deliberate with how you present your online business to customers. (A. Kim, 2011)

The priorities mentioned above are essentially part of what Ralph Lauren has determined to be the critical success factor in South Korea and globally: “Elevate the brand.” (Kimpton, 2011)

Luxury companies often speak about elevating their brand to differentiate themselves from their competitors and create brand loyalty. However, loyalty is developed with long-term relationships where customer attitudes toward that brand are consistently high and favorable. If a brand's image is suffering, it can be difficult to change those perceptions with a short-term marketing campaign. Companies should pursue a long term identity bombardment in the region of interest to change customer's perceptions and elevate the brand image. (M. Kim et al., 2010)

2.3 Now Available Online!

South Korea is often described as the World's most wired country. The *Basic Act on Informatization Promotion* of 1995 gave the country 22,000 km of fiber-optic cable lines and 118 high-speed switching systems to cover the entire country with internet and wireless services. It was the first country to launch a 3G wireless platform, in October, 2000, and it has been at the forefront of information technology infrastructure and services since. In 2011, internet penetration in South Korea was approaching 82%. (EIU, 2011) The high proliferation of internet and wireless technology combined with high computer literacy and acceptance “puts the country at a unique advantage to exploit e-commerce.” (EIU, 2007) And South Korea has done just that. Out of the three types of e-commerce present in South Korea – Business to Business (B2B), Business to Government (B2G) and Business to Consumer (B2C), B2B is the largest, followed by B2G. But B2C grew the fastest in 2009 – by 32.5% to 15.6 trillion Won (\$13 billion). (EIU, 2011) Online shopping is gaining popularity – but not equally in every category. “The cybershopping categories that saw the largest growth in 2010 were household goods (31.3%), sports equipment and leisure goods (27.5%), and travel services (27.2%).” (EIU, 2011)

E-commerce in South Korea and around the world has grown at an incredible rate over the past twenty years – and so has the literature related to it. To cull out the relevant information, we focused on supply-chain oriented e-commerce research which is most applicable to Ralph Lauren's challenge in South Korea. “E-commerce” and “E-retail” (we use the terms interchangeably in this thesis) have been household words since the mid-90s, when companies like Amazon, Staples, and E-Bay emerged as leaders of the new business model. From the internet bubble and its subsequent burst, countless articles, books, and analysis have been written

– many of which suggest a strong link between a company’s strategy, supply chain, understanding of the customer, and the success of an e-commerce initiative. The best-selling book *Good to Great*, by Jim Collins, highlights an example where Walgreens was able to “tie the internet directly to its sophisticated inventory-and-distribution model” to sustainably support its growth and capture more customers than the much-hyped internet pharmacy startups like *drugstore.com*. (Collins, 2001) Without having a robust supply chain to support their e-commerce strategy, companies like *drugstore.com* were destined to be the subject of case studies.

Many companies who jumped on the e-commerce bandwagon in the 90’s were convinced that simply adding a “.com” to their name would boost sales three-fold. For some products it turns out that this is true – office supplies are a perfect example and Staples.com is now the number two e-retailer in the world (second to Amazon.com). In fact, of the top 10 e-retailers in the world, three are office supplies companies. (The Top 500 List, 2010) But Luxury goods are different – and more so in South Korea. Because sales are strongly related to brand image (which *may* be negatively affected by internet retail), luxury goods are intuitively not a strong candidate for e-commerce. However, with limited shelf space in South Korean department stores, e-retail is a great way to offer a higher product assortment to customers.

Once South Korean customers place an order online, delivery expectations are relatively standardized. Because of the high population density and relatively small geographic footprint of the country, two-day delivery is typical for most e-retail transactions. In luxury apparel, a recent trend is for customization and personalization of goods – companies like Bean Pole have this service with their e-retail channel but delivery can be up to 2 weeks. Ralph Lauren, on the

other hand, is able to provide this service in the U.S. market with just a few days of lead time and they plan on implementing it in South Korea as well. (Stylianou, 2011)

In *Key Factors for e-Commerce Business Success*, Choi, Park, Lee, and Ryu point out that e-commerce customers face a high degree of mediation when shopping online. The ability to see and touch the merchandise, interact with store employees, explore the product space and assess the trustworthiness of the brand is negated when the customer is not in the physical store. Choi et. al point out that there are a set of key success factors for e-commerce winners as well as critical failure factors that inhibit growth. The 9 key success factors are: value (in terms of convenience, price, choice and information), niche market, flexibility, geographical segmentation, technology, critical perceptions, exceptional customer service, effective connectedness, and a thorough understanding of the internet culture. The 6 critical failure factors are: low data security, inconvenient use, unstable system, lack of information, dissatisfied purchasing, and social disturbance. The most competitive e-commerce players use a “value innovation” model to approach the market – their strategy is derived from an understanding of what their customers want and not letting the existing industry norms stifle their operation. Another attribute of these value innovators is that they “monitor competitors but do not use them as benchmarks,” as it is seen as a waste of resources to make decisions based off competitors’ actions. (J. K. Choi et al., 2006) While Choi et. al provide a list of the “key factors to e-commerce success,” that list seems more geared towards internet startups. However many of the items are generic enough that they are applicable to existing firms. The list includes: tangible assets (financing, facilities, and supply chain), intangible assets (technology, customer base, brand and image), and processes (organizational processes, service offerings, and customer relation management). (J. K. Choi et al., 2006)

The key factors to success described above are certainly good guidelines for any e-retailer, but luxury consumers are a different breed, and it is important to understand their buying habits. Study participants from Kim's 2010 investigation reported having a low "pride of possession" when luxury goods were purchased through e-retail, because they perceived less scarcity of the product when it was available online. (M. Kim et al., 2010) Scarcity and uniqueness of the product are highly important to South Korean luxury consumers. Lower prices typical of TVHS, e-retail, and outlet stores increased "economic value" of the brand, but caused concerns about quality and authenticity, leading to lower satisfaction levels. Interestingly, participants believed luxury brands that were sold through e-retail with heavy discounts were counterfeit. The researchers concluded that no matter which channel was added to the traditional brick and mortar model, there was a negative effect on brand image. For this reason, they recommend that luxury companies who are exploring other distribution channels think strategically about their customers' expectations and their perception of the brand. For example, luxury brands that are implementing e-retail should set an appropriate price strategy because the most attractive aspect of internet stores is low prices, but at the same time, those low prices can cause consumer distrust of the brand. Further, internet stores can improve utilitarian value by offering 24 hour availability and a consistent and reliable returns policy. Companies should be aware that these policies can cause a surge in returns, so they should buy insurance to hedge this risk. (M. Kim et al., 2010)

Given the above recommendations and analysis, e-retail should be attainable for many luxury companies. So then why are luxury brands so late to the e-retail game? Why is this industry, which has traditionally been at the forefront of innovation, technology, creativity, culture and cool just now approaching online channels (and with much trepidation)? Ukonkwo (2010)

directed this discussion toward how internet commerce began: low price consumer goods for the masses. Companies like ebay.com and Amazon.com attained their success by leading online customers down a path of searching, comparing and minimizing costs for products of varying levels of quality. Coco Chanel was known to have said “Luxury is a necessity that begins where necessity ends;” luxury brands wouldn’t dare get caught mixing their high-end items with “price-discounted mass products and damaged goods.” (Okonkwo, 2010)

Okonkwo relates that there are several commonly cited reasons for staying out of e-retail, but it really comes down to the luxury brands’ desire to control their image. The fear of losing control has caused many luxury brands to avoid e-retail (what he calls “e-luxury) altogether for the past decades. However, it has become apparent that merely staying offline will not protect the company’s ability to protect and control its brand image. In fact, Okonkwo asserts, “luxury brands no longer control their existence in cyberspace...the control today is limited only to each brand’s own website.” (Okonkwo, 2010) He further explains that consumers have all the power; they can “create, control, contribute and influence not only web content but also their web experiences and those of millions of others around the world.” (Okonkwo, 2010) Consumers will no longer accept one-way communications from luxury brands in the form of traditional advertisements – they have more trust in information provided by peers who post reviews, blogs, messages and articles about the most recent luxury trends in their own social organizations such as asmallworld.net, facebook.com, and myspace.com. Okonkwo suggests that e-luxury cannot be ignored, but it also should not be engineered. Discussions between luxury consumers in “Web 2.0” (the social networks and blogs that typify the last five to ten years of the internet) are much more powerful than any force that has acted upon a brand’s image in the past (such as a traditional marketing campaign or press release). Luxury brands who have identified this and

tried to manipulate Web 2.0 have so far met failure. For example, in 2005, the French brand Vichy engineered a blog featuring a character named Claire who wrote about one of Vichy's wonderful new products. Customers caught onto the farce and denounced Vichy. Because the social web values openness and trust between users and their opinions, "stealth marketing" ploys (where companies attempt to pull the wool over customers' eyes) will never be a sustainable way to approach e-luxury in Web 2.0. Instead, Okonkwo suggests that luxury brands participate, actively and honestly, in the social web by monitoring the blogosphere, forming relationships with influential bloggers and join in on blog discussions "through reps that are real people with a name and a face." (Okonkwo, 2010)

Okonkwo makes an interesting allegation that "online consumers are more website loyal than brand loyal." (Okonkwo, 2010) Since the only thing a brand can control is their own website, luxury e-retailers need to present their online image as a seamless extension of their offline identity. Okonkwo provides tactics on how luxury brands should build their websites, although admits that there is no one-size-fits-all approach. *Webmospherics* is a strategy that companies use to attempt to create a specific and unique online atmosphere that is a reflection of their product or service offering. Okonkwo brings this a step further into a realm he calls *luxemospherics*. The goal of luxemospherics is to have a luxury brand's website elicit an emotional response in consumers that reinforces their perception of the luxury product. He explains how websites that utilize principles of the luxemosphere "use elements that influence the senses, stimulate the mood and enhance the emotions through sensory technologies" to reproduce the feelings that customers have for that brand specifically. (Okonkwo, 2010)

Okonkwo questions the standard assumptions that luxury brands make about their online product selection. Previously, companies who approached luxury e-retail did so with a limited SKU

assortment – believing that their under-performing items might be sold off through internet channels. However, as companies like Hermes’ online “gift selection” started taking off wildly, they began to second guess their decision. Okonkwo states that “the choice of products to sell online should follow the strategic objective of e-retail for the brand.” Companies may seek to generate exclusivity from their website, or track information and enhance their relationships with customers, or generate sales volume or disseminate the brand image – these goals should be in line with the company’s strategy. For example, e-stores that aim to generate top line sales growth may need to offer a broad product range at various price points on their website. E-stores that want to push their image and exclusivity may want to offer a smaller selection of higher priced items through a “members-only” interface. Okonkwo asserts that price discounting can be dangerous and that if prices are reduced, it should be “done in an intelligent manner that doesn’t literally kill the dream that the brand offers.” (Okonkwo, 2010)

2.4 Bringing it Together

Since e-commerce emerged as a business model in the 90s, companies have been trying to leverage innovative opportunities and manage unforeseen threats. Customers in mature markets such as the U.S. can easily identify trustworthy brands – but those brands had to earn that trust by operating consistently with high quality and service levels. The rewards for complementing a brick and mortar operation with e-commerce are often manifested as increased supply chain efficiency (by consolidating stocking points and lowering inventory), a broader SKU assortment (by accessing inventories of all stocking points), and a boost in sales (by offering customers a point of sale that is open 24 hours per day). It is clear for many companies that a click and mortar model is the optimal business model and the only way to stay competitive in the market.

There are several ways to approach the integration of clicks and bricks but there is no solid indication of which is the best – companies seem to be experimenting with several models. (Bendoly, Blocher, Bretthauer, & Venkataramanan, 2007)

Hill, et. al have identified the main methods for running a click and mortar operation.

Companies like J.C. Penny and Staples have opted to segregate their in-store and online divisions both at corporate and in their supply chain. This ensures that their retail division doesn't suffer any hiccups during integration, but a main drawback is that inventory and supply chain efficiencies cannot be reaped (as there is now a separate inbound, warehousing, and delivery network). Some companies such as Wal-Mart, Macy's and Bloomingdales have no desire to deal with e-commerce at all, but still want a presence online – these companies segregate at an extreme level, outsourcing all of their internet orders to third party firms. (Hill et al., 2002)

Another strategy is called the “professional shopper” – where online orders drop directly to a retail store and an associate picks, packs, and ships the order from a store backroom. The drawbacks for this model include inefficient picking operations (stores aren't designed like warehouses), lack of space (especially in countries like South Korea, where every square foot of a department store is used to for product presentation), and customer service impact (if employees divert too much attention away from in-store customers to satisfy online order fulfillment). (Hill et al., 2002)

Bendoly (2004) investigated the optimization of a supply chain (in terms of cost and service) when inventory substitution situations occur as well as when different mixes of online and internet sales exist. Bendoly wrote that “The use of local store inventory for both in-store and on-line fulfillment can be preferable to the central warehousing of on-line stock in certain scenarios.” (Bendoly, 2004) He explained that combining the management and storage of online

and in-store inventory in a de-centralized model has a similar pooling effect to that of a centralized distribution model that can mitigate demand variability and reduce inventory holdings. However, these savings are increasingly offset by coordination and transportation costs as the network gets more complex.

Bendoly (2004) first created a model that investigates how substitution affects stock-out events among neighboring stores that satisfy both online and in-store demand. Bendoly's model has limitations due to simplification; it operates under pre-determined service constraints and operational assumptions such as prioritizing the fulfillment of in-store demand over online sales, the inability for stores to ship inventory to other stores, and unfulfilled demand resulting in backorders instead of lost sales. (Bendoly, 2004)

Bendoly's second model (Bendoly, 2007) investigates how different proportions of online versus in-store demand affect total supply chain costs, under pre-specified service level assumptions. Using this model he explores when, if, and to what degree decentralization of online inventory to the stores should occur. His findings show that a point of inflection exists where decentralized inventory no longer financially makes sense and a centralized fulfillment center would provide more benefit to the company. There are several levers he uses to investigate the threshold such as number of stores, demand variability, and sales volumes, but interestingly, Bendoly found that a mixed model of centralized and decentralized inventory was never an optimal solution. (Bendoly et al., 2007) Bendoly's model served as our inspiration to explore how different in-store and online services, inventory policies, and operating procedures might affect Ralph Lauren's brand image and business performance in South Korea.

3. METHODOLOGY

Ralph Lauren's initial interest in this thesis was to analyze and discuss how to effectively capture the luxury e-retail opportunity in South Korea while elevating the brand. From the beginning we focused on gathering data on the luxury retail sector, the business environment in South Korea, and the nature of e-retail. With a basic working knowledge of the state of the art in those three areas, we reached out directly to Ralph Lauren for more specific, strategic data gathering about the company and its operations. We were offered an opportunity to make several site visits, which we decided would be essential for our understanding of the business and the brand.

"Luxury" is an experiential concept – we needed to experience it ourselves to fully understand it.

After obtaining information on the company, brand, and operations from interviews and site visits, we began to analyze Ralph Lauren's challenge through different strategic frameworks such as SWOT Analysis and Porter's Five Forces. SWOT and Porter's Five Forces are frameworks that help evaluate an industry, as well as a company's position in that industry (Van Assen, 2009). These strategic analyses brought us back to Ralph Lauren's originally stated objective – that elevating the brand would be critical to their success. More interestingly, the strategic analyses also prompted us to explore *which* factors affect the brand.

With a clear focus on our central issue, which is to elevate the brand while introducing e-retail, we then employed a system dynamics perspective to map out the interactions of factors that affect the brand's image. Defining the system was an iterative process and it is not comprehensive by any means – there are simply too many factors at play to suggest that one is more important than another. However, exploring the system dynamics model allowed us to narrow down what the critical strategic factors are for elevating the brand.

3.1 Field Research

Coco Chanel famously said that luxury “is a necessity that begins where necessity ends.”

Gaining an intuition about what a brand feels like and how luxury is portrayed by Ralph Lauren is critical for our research – with this in mind, there is no substitute for field research. Visiting the Ralph Lauren facilities in Seoul, New York City, and High Point, North Carolina provided us with the opportunity to peak behind the velvet curtains of the luxury industry, and form an understanding of how operations affect customers. This field research proved critical to our understanding of Ralph Lauren’s brand image, customer relationship management, supply chain operations, and company culture.

“Field Research” can be broadly defined as any uncontrolled observation by researchers on study subjects, and can be critical in the study of operations that cannot be authentically simulated in a controlled environment. (Gilbert, 2004) By its very nature, field research requires researchers to interpret observations; thus these interpretations should be contrasted and questioned in order to form an objectively realistic understanding of the situation.

In our case, we were able to contrast the operations in Korea with those in the U.S., as well as contrast e-commerce fulfillment with brick and mortar distribution. These comparisons created a structure from which we could analyze our observations. A description of what we saw from these visits, and some insights we gained from those experiences will be discussed in chapter 4.

3.2 Frameworks for Strategic Analysis

With all the information we gathered through existing literature, site visits and interviews, we needed a way to organize our thoughts and examine Ralph Lauren’s challenge. Two strategic

frameworks – “SWOT Analysis” and “Porter’s Five Forces” – are useful in analyzing the business environment of a project or scenario.

3.2.1 SWOT Analysis

SWOT Analysis has been a staple in business schools since Stanford researchers Robert Stewart and Albert Humphrey developed the concept in the 1960’s. SWOT (strengths, weaknesses, opportunities, threats) is a strategic planning tool used to help managers make decisions. The SWOT framework first focuses on a central object of analysis (a goal or project), and then focuses on the internal and external factors that will influence the success or failure of that object. (Lindblad, 2011) For Ralph Lauren, we chose the object of the SWOT analysis to be “the e-retail opportunity in South Korea.” The SWOT analysis of Ralph Lauren will be discussed further in chapter 5.1.

3.2.2 Porter’s Five Forces

In 1979, Harvard University’s Michael Porter developed the “Five Competitive Forces that Shape Strategy” in an effort to improve SWOT Analysis. While it is similar to SWOT in many respects (they both attempt to help managers make decisions), Porter’s method is more geared toward defining the attractiveness of an “industry” and illuminating factors that influence the industry. For our discussion, the “industry” we are investigating is e-luxury in South Korea. Like SWOT Analysis, Porter’s Five Forces have been the substance of business school classes for decades. The forces that Porter identified as making an industry attractive or unattractive are: “Barriers” (threat of entry), “Rivalry” (intensity of competition), “Substitutes” (availability of substitute products or services), “Buyers” (bargaining power of buyers), and “Suppliers”

(bargaining power of suppliers). (Porter, 2008) The Porter's Five Forces analysis of Ralph Lauren will be discussed further in chapter 5.2.

3.3 System Dynamics – A Relationship Perspective

There is a precedent of a model that may be applied to companies facing e-retail expansion. Bendoly (2007) exhibited a tradeoff point at which it is more cost effective to centralize fulfillment capabilities from a single warehouse. An initial review suggested it may be applicable to Ralph Lauren's operations in South Korea; however, further investigation revealed that Bendoly's model may be better applied to a firm that has an existing e-retail history and presence – Ralph Lauren has not yet rolled out e-retail in South Korea. And perhaps most importantly, Bendoly's model is not tailored to the nuances of e-luxury, and it doesn't address the value of a brand – a central concept in our research. Our final departure from pursuing Bendoly's model came about when discussing the relevance of his research for Ralph Lauren's e-retail challenge in South Korea; the question of when to invest in a central distribution center wholly dedicated for e-retail is often simply answered out of necessity. When e-retail sales are too high to be satisfied from the back-room of a store, or when your retail operations start to feel a negative operational impact from servicing these orders, it is time to invest in a fulfillment center. However, something that can be applied from Bendoly's model is the insight into just how complex the click-and-mortar system is for Ralph Lauren in South Korea.

Instead of trying to quantify and minimize the total supply chain cost, as Bendoly did, we started to question what other factors might contribute to Ralph Lauren's success – we returned to their paramount goal and our central concept: elevate the brand. Our research alluded to the numerous variables that affect customer's perception of a luxury brand, and we sought to map out these

variables and identify how their interactions might contribute to the success or failure of Ralph Lauren's e-luxury business, and operations in South Korea as a whole. The field of system dynamics is especially useful in mapping out the interrelatedness of variables to analyze a system's behavior. (Sterman, 2010)

System dynamics is a "perspective and set of conceptual tools that enable us to understand the structure and dynamics of complex systems." (Sterman, 2010) The behavior of a system (or a set of related factors in an environment) often cannot be completely explained by the sum of its parts. Rather, it is the interaction of those parts that determines the behavior and output of the system. We used a program called *Vensim* in our research to map out causal loop diagrams that are part of Ralph Lauren's e-luxury system. A causal loop diagram (CLD) is a system dynamics tool that helps users to qualitatively map out a system's structure. CLD's are best employed to get a "big picture" idea of how the different factors in a system interact to yield a generic output over a specific time period.

To get a better understanding of system dynamics, we will introduce a few definitions:

- Variables: the factors that make up the system
- Causal Link: the relationship between two variables, represented by an arrow
- Polarity: the effect of that changing one variable has on another – either positive or negative
- Causal Loop: a complete circuit of variables that are related to each other
- Loop Identifier: either positive ("R" for reinforcing) or negative ("B" for balancing).

A simple causal loop diagram (CLD) is displayed below in Figure 3 – it represents a system of birth and death rates. (Sterman, 2010)

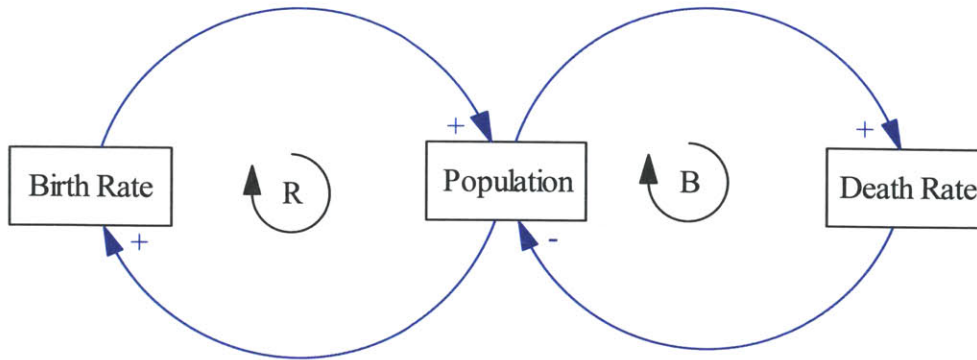


Figure 3: Causal Loop Diagram (CLD) of Birth and Death Rates

Note the variables (Birth Rate, Population and Death Rate), the links (arrows), the polarity (+ or -) and the Loop Identifiers (R and B). This CLD indicates that an increase in birth rate increases the total population, which increases the birth rate even more. This is represented by the left-hand loop labeled “R” for “Reinforcing.” The right-hand loop is denoted with a “B” for “Balancing” – because an increase in total population will increase the death rate, which in turn decreases the total population. Our use of system dynamics will be discussed further in chapter 6.

4. FIELD RESEARCH

4.1 U.S. Store Operations

Touring Ralph Lauren's "Madison Avenue Mansions" – the Ralph Lauren "flagship stores" located in New York, New York – provided us with a chance to meet with the Director of Operations. He walked us through the store and explained to us how every detail of the store is deliberately planned out – from the lighting, to the smells, to the squeak in the floor of a particular room.

The stores allow Ralph Lauren to create the space, and the luxury experience, that is intended for their customers. They have complete control of the brand image within these walls, and their best customers come back time and again to live this experience. The Director also allowed us to explore the stock room and customization stations in the basement. The in-store customization capability allows personal touches to be added to "blank" products while the customer shops for other items. For example, monikers, initials or other symbols can be sewn into a customer's shirt, pillow or other item – often taking less than 30 minutes. While the customization stations and blank inventory in the stock room take up critical real estate, they are the type of services that differentiate Ralph Lauren from other luxury brands and they are in-line with the expectations of high-end customers.

A few blocks away is the "RRL" flagship store. The repeat RRL customers are fanatics about this brand and it is easy to understand why. The RRL General Managers explained that RRL is a specialty brand within Ralph Lauren that is focused on the image of vintage military and work-wear. RRL often uses original antique equipment and traditional processes to manufacture

products. The results are high-quality fashion products unlike anything else on the market. Their unique sourcing is matched with in-store presentation that helps to reinforce the brand image. The tight-knit family style network of RRL stores and employees allows them to create relationships with their customers that further drive loyalty. Critical to this operation is the sharing of information between systems, stores, and employees. For example, one unique, long-time RRL customer desired to take a “traditional” trip from LA to New York (via train) to see the RRL flagship store. Coordination between store managers on each coast provided the New York team with ample time and information to prepare a gift for this customer upon his arrival, tailored to his individual interests. This is one example of how RRL is able to create exclusive experiences and life-time loyalty among its customers.

Both management teams exposed us to Store-Net – the IT system that supports Ralph Lauren’s pooled inventory between the brick-and-mortar and e-retail channels. This system provides SKU-level visibility across all stores as well as the central fulfillment center dedicated to e-retail. Store-Net enables retail associates to leverage the inventory in other stores as well as the central fulfillment center to reduce lost sales due to stock-outs. It also provides a method to augment in-store sales with complementary e-retail sales, which can enhance the customer experience. Store-Net also allows online orders to be fulfilled from stores if, for example, the e-retail fulfillment center stocks out of a particular SKU, but it is available in one of the stores. In that scenario, the order will be dropped to the retail store, which can then choose whether or not to pick, pack and ship the item from its stock room.

While all items are visible to Ralph Lauren associates through Store-Net, we discovered that not all Ralph Lauren products are visible and available to customers through the Ralph Lauren website. In fact, Ralph Lauren carefully controls which items can be purchased online – it is an

important part of managing and elevating the brand image. It allows them to control which items can be obtained without interacting with Ralph Lauren associates and which items warrant the in-store experience. As expected, most of the Blue Label items and many accessories are available online, but fewer of the Collection items can be purchased without visiting a store or at least having a phone conversation with an associate. The logic behind this is to elevate the brand; Collection items are high-touch items while Blue Label items require less personal interaction with customers, and can therefore withstand the effects of mediation (we will elaborate on this concept in chapter 7). This is how we suspect Korean e-retail will operate as well, as Ralph Lauren attempts to re-align its operations with the brand goals of the company.

One of the most interesting aspects of Store-Net is that it aligns the appropriate behavioral drivers with the business model. To increase online sales and offer customers a greater variety of items that might not be presented on the shelf, retail associates are equipped with handheld tablets such as the iPad®. These associates log into Store-Net and, when they are able to help customers purchase additional items online (we call this a “complementary sale”), they are rewarded. This method of providing incentives and commissions to store associates for creating e-commerce sales events is a perfect use of a behavioral driver in the U.S. It could also be a big win in Korea because it is an effective method for encouraging customers to use the new e-retail platform.

Another important takeaway from our discussions with the New York management teams was the concept of customer service and creating relationships. As one might expect from a luxury lifestyle company, Ralph Lauren provides its clients with several echelons of amenities.

Services range from champagne for customers while they shop to in-store customization and same day delivery of items. One of the more important luxury experiences that management

heavily promotes is the use of their “black car service” – literally a high-end Mercedes or other luxury car that is used strictly to pick up and drop off customers (or their merchandise) from their residence, place or work, or other location.

The NY flagship store manager offered an anecdote of two customers: one is a repeat customer at Ralph Lauren – a wealthy local businessman with his own personal driver; the other is a first-time visitor to the flagship store – a middle-income tourist from out of state. When management sees these two customers in the store, they pay high attention to their repeat customer, maintaining their relationship with him by providing the level of service he expects; however, they understand that there is an opportunity to create a new life-time Ralph Lauren customer by giving the tourist a ride back to his hotel using the black car service. Again, leveraging the concept of the “luxury experience,” Ralph Lauren consistently attempts to differentiate itself from other competitors by thinking innovatively, acting extraordinarily and individually tailoring its operations to each potential customer.

4.2 U.S. Fulfillment Center

Our trip to High Point Direct (“HPD”), a facility located in North Carolina, gave us a better understanding of the fulfillment operation that Ralph Lauren employs to satisfy U.S. online demand. This visit gave us a rough estimate of what sort of investment is necessary in a mature e-luxury market in terms of scale, inventory, and labor. This facility employs a Warehouse Management System (WMS) as well as an automated sorting system to track and move inventory throughout the warehouse. By aggregating online demand, labor and inventory under one roof, Ralph Lauren is able to take advantage of the economies of scale that e-retail provides. The facility is run very efficiently, but still provides customers with the service they expect from

Ralph Lauren. Customer focus is paramount, even though these associates never interact with customers face-to-face. This is seen especially at the packing stations, where skilled associates take care to ensure the way the customer receives their merchandise (the packaging and presentation of their order) is in line with the Ralph Lauren luxury experience and brand image. Our experience at HPD gave us a benchmark to measure other potential luxury e-retail facilities against.

4.3 Seoul Department Stores

Visiting several department stores in Seoul, including Hyundai, Lotte and Shinsegae, helped us better understand Ralph Lauren's current business challenges and future opportunities to elevate the brand in South Korea. Located within each department store may be one or several Ralph Lauren stores (a dedicated "Black Label" store on one level may compliment a generic Ralph Lauren store on another level, for example). As mentioned earlier, all of their operations had been previously licensed out to Doosan Corporation, so Ralph Lauren had little control over the management of store space, product mix, and other operating levers. Now that Ralph Lauren has taken back the license, they can start to rebuild their brand by segmenting out stores this way, as well as managing their merchandising more carefully. We saw that space in the department stores (and in the city in general) is very limited and extremely expensive, and competition for Blue Label "equivalent" brands is fierce. We also saw first-hand how the department stores, which are owned by Korean Chaebols, have incentive to strategically locate Ralph Lauren stores near their brands (i.e. Bean Pole), in an effort to benefit from the Ralph Lauren brand image. On several occasions, we visited a Ralph Lauren store and saw right across the hall was a Bean Pole store. We verified our assessment of Ralph Lauren's damaged brand image during interviews

with Korean customers. They see Ralph Lauren a certain way – as a competitor of Bean Pole – rather than a competitor of other luxury lifestyle brands like Louis Vuitton, Gucci or Prada.

We discovered that several other luxury brands can currently be purchased online through the department stores' websites. This surprised us, since we thought that many luxury brands were still in “online-avoidance” mode. However, the caveat to those online operations is that they are managed by the department stores. As such, the department stores have incentive to harvest the brands (as typical for license holders) so they will use demand management levers such as discounts and loyalty programs to drive volume and future sales. For instance, Samsung (the Chaebol that owns the Shinsegae department store and also owns Bean Pole) might offer a discount for their Bean Pole items in the form of points for their “Shinsegae Loyalty Program.” Ralph Lauren has decided that this is not the appropriate strategy for them to elevate their brand. In fact, they would never want to offer discounts on their own merchandise, or partnership points with another retailing entity, because they see such practices as commoditizing their products and cheapening their image.

4.4 Seoul Flagship Store

Prior to our visit, we had only done preliminary research about Korean luxury customers, so our mental model was based solely on literature. Visiting the stand-alone store in Seoul and having the opportunity to interview local customers and employees, and discuss the habits of Korean consumers helped us validate and/or refute many of our initial assumptions. For example, we knew that high-end luxury retail was on the rise and that most Koreans have no reservations when it comes to spending money on luxury goods (there is generally a low “guilt factor” for purchasing luxury items, as they are not seen as a waste of money). However, given this

mentality, we were surprised to find out that many Korean customers are actually very value driven – they will opt for lower priced items, particularly if they are perceived as equals (such as Ralph Lauren’s Blue Label and Bean Pole).

This explains much of the success of Bean Pole – a lower-tier luxury brand that competes with Ralph Lauren’s Blue Label with aggressive pricing discounts. The higher end customers, however, are typically repeat customers looking for a unique service and luxury experience. We found that this segment of customers – the Collection customers – help drive the brand image as a whole. As such, Ralph Lauren should continue to focus its attention on satisfying these customers, but with the goal of having their satisfaction trickle down to lower and mid-tier brand consumers. The goal should be to always have Blue Label consumers aspiring to the next level of luxury – Collection. We also learned that high-end luxury customers are more likely to “buy down” – meaning they will also purchase Blue Label items – than Blue Label customers are to “buy up.” When they do “buy up,” Blue Label customers are most likely to purchase *accessories* at the Collection level. This is presumably so because accessories offer more luxury value to Blue Label customer “buying up”.

Our interviews confirmed that individualism and customization are becoming key priorities for South Korean luxury consumers (and they are less-often drawn toward a luxury label due to its name and reputation alone). We believe that Ralph Lauren is in a unique position to meet these changing customer tendencies better than the competition – and they can elevate their brand image at the same time by offering differentiating services across all label levels (Blue and Collection). For example, since retail space is so limited, but the geography of South Korea is such that most customers are within next-day-delivery range, Ralph Lauren can leverage its customization capabilities outside of the retail stores (at the central distribution center) and

possibly deliver customized items within 24 hours. To put this into perspective, Bean Pole offers a customization service that has a 2-week lead time.

4.5 Seoul Distribution Center

Ralph Lauren's Seoul Distribution Center – the warehouse that supports South Korea retail operations – is quite different than HPD. While HPD is dedicated to mainly break-pack shipments for online customers, the Seoul Distribution Center (SDC) has been used to support retail operations in Seoul. However, unlike most retail replenishment in the U.S., the limited inventory capacity in Korean retail stores often requires daily replenishments in break-pack (or individual) unit quantities. Essentially, the SDC is already performing next-day-fulfillment in break-pack units, which is precisely what e-retail would require. The SDC in its current location is multi-level, and low-technology – but it is effective. Ralph Lauren intends to move within the next year to a new DC, in a more traditional single-level industrial park. The additional space should give Ralph Lauren the flexibility to implement and grow e-retail in South Korea without affecting retail operations.

5. FRAMEWORKS FOR STRATEGIC ANALYSIS

In the following chapter we use SWOT Analysis and Porter's Five Forces Framework to analyze Ralph Lauren's e-luxury challenge in South Korea.

5.1 SWOT Analysis

SWOT Analysis begins by exploring the internal **strengths** of Ralph Lauren that make it able to exploit an opportunity. We first ask the question: What internal characteristics of Ralph Lauren are likely to positively influence the e-retail opportunity in South Korea? These characteristics include:

- Previous experience (and success) with e-luxury in other markets
- Customization capabilities
- Motivated and knowledgeable implementation team
- SKU and customer segmentation already organized to support e-retail
- Alignment of supply chain, marketing, IT teams around a common goal: "elevate the brand"
- Economies of scale from aggregating inventory and labor under a single roof (SDC)
- 24/7 sales window (i.e. the e-retail store never closes)

Next we identified Ralph Lauren's internal **weaknesses**. The basic question regarding weaknesses is: What internal characteristics of Ralph Lauren are likely to negatively influence the e-retail opportunity in South Korea? We identified the following characteristics:

- Limited flexibility in pricing (i.e. no discounts or sales)

- Rolling out an e-retail operation at a time that the brand is damaged

Third, we probed the external **opportunities** that affect Ralph Lauren. The basic question regarding opportunities is: What external conditions beyond Ralph Lauren's control are likely to have a positive effect on the e-retail opportunity in South Korea? We identified the following characteristics:

- Luxury market is growing in South Korea
- e-Commerce market is growing in South Korea
- Korean luxury consumers request greater customization, something that Ralph Lauren can provide
- e-Commerce will free up space in retail stores for Collection items by moving Blue Label items to the central DC – which can elevate the brand

Finally, we explore the external **threats** facing Ralph Lauren. The basic question regarding threats is: What external factors beyond Ralph Lauren's control are likely to have a negative effect on the e-retail opportunity in South Korea? We identified the following characteristics:

- Fierce competition from Bean Pole & others
- Continued impact on Ralph Lauren's business operations from Chaebol / department store
- Improper implementation can further damage the brand image in Korea
- Potential for weak demand for high-priced items online within the traditional core luxury market due to "department store culture" (this applies to all players in the market, and may be more of a challenge than a threat)

In Figure 4, we display the SWOT analysis:

		Helpful	Harmful
Internal Origin	Strengths:	<ul style="list-style-type: none"> Previous experience (and success) with e-luxury in other markets Customization capabilities Motivated and knowledgeable team Pre-existing SKU and customer segments IT / supply chain / marketing alignment to enhance brand message Economies of scale (inventory, operations, etc.) at Seoul DC More selling opportunities (24/7 store front) Greater access to customers (outside of metro area) 	Weaknesses: <ul style="list-style-type: none"> Limited flexibility in pricing (i.e. no discounts or sales) Rolling out an e-retail operation at a time that the brand is damaged
	Opportunities:	<ul style="list-style-type: none"> Luxury market is growing in South Korea e-Commerce market is growing in South Korea Korean luxury consumers request greater customization e-Commerce will free up space in retail stores for Collection label - which can elevate the brand 	Threats: <ul style="list-style-type: none"> Fierce competition from Bean Pole & others Continued impact on Ralph Lauren's business operations from Chaebol / department store Improper implementation can further damage the brand image in Korea Potential for weak demand for high-priced items online within the traditional core luxury market due to "department store culture"
External Origin			

Figure 4: SWOT Analysis for Ralph Lauren

We noticed that each quadrant contained a pertinent reference to the brand image, which made us wonder how the brand image could both impact e-luxury, and also be impacted by e-luxury. This is when we began to look more closely at which factors affect the brand image.

5.2 Porter's Five Forces

The first step in executing a Five Forces analysis is identifying the **barriers** that exist for an industry. We began by asking the question: What keeps other companies from engaging in e-luxury in South Korea?

We found the barriers to entry to be **moderate**. Regulation is negligible in this industry, access to distribution is widely available to all participants, and capital requirements can be very low (a

craft worker making luxury items out of his garage and selling them online, for example).

However, product differentiation, brand equity and customer loyalty can be significant barriers for new entrants who are trying to compete with other well established luxury companies in South Korea. For example, once Ralph Lauren is well-established as a brand in South Korea, customers will be less inclined to switch to other brands such as Bean Pole.

The second step in executing a Five Forces analysis is identifying the sources of **rivalry** within an industry. We asked the following question: What is the intensity of e-luxury competition in South Korea?

While “competition” between companies is fierce, we found the intensity of competition in the e-luxury industry as a whole to be **low**. There is a limited number of companies that are the same size as Ralph Lauren (Gucci, Prada, LVMH and Burberry are a few of the major competitors). Product differentiation enables customers to form a lasting relationship with their preferred luxury brand. Since the industry is not yet mature (it is still growing rapidly) there is room for most luxury brands to share a large piece of the profits generated by e-luxury in South Korea.

The third step in executing a Five Forces analysis is identifying the potential **substitutes** for a product or service within an industry. We asked the following question: What is the propensity of luxury consumers to spend their money on other goods?

We found this propensity to be **low**. Substitutes – not to be confused with merely competitor’s products – are entirely different sources of satisfaction for luxury consumers. For example, in the transportation industry, a substitute for taking an airplane from Atlanta to Boston is to take a train instead (not another airline). In general, there is no substitute for a luxury item, due to the nature of “luxury.” Luxury consumers typically have disposable income (especially the high-end

luxury consumers) and they demand products, services and experiences that are unique, high quality and customized. Individually tailored luxury products and services are not necessarily perishable, but they can be one-of-a-kind (or limited editions) which make them difficult to substitute.

The fourth step in executing a Five Forces analysis is analyzing the power of **buyers** within an industry. We asked the following question: What degree of pressure can customers put on Ralph Lauren's e-commerce business?

We deemed the buyer power to be **moderate**. Normally, there are many luxury customers and they typically purchase in small quantities multiple times per year, so they do not have volume power. However, due to the rapid growth and purchase power in Korea, the broad customer trends are changing and it is unknown exactly how they will respond to luxury online. In addition, luxury goods are highly differentiated (if the products and brand image are correctly managed) which keeps customers from switching brands. Luxury goods also typically represent a small fraction of high-end customers' resources, meaning they have no concern for seeking out the lowest price. However, for lower-end customers (such as Blue Label) where their luxury spend is a larger percentage of their income, competitive pricing is more important; these customers have greater power over luxury companies due to their tendency to switch between brands if the perceived value is greater.

The final step in executing a Five Forces analysis is identifying the power of **suppliers**. We asked the following question: How powerful are the suppliers to e-luxury (both technology and product vendors)?

We deemed the supplier power for e-luxury to be **moderate**. Presuming Ralph Lauren will outsource much of the website development for its e-commerce site in Korea, there are a large amount of development companies that can market to a specific group (such as luxury), but fewer companies actually have experienced success in creating e-luxury websites that meet the brand requirements of the retailer. Also, suppliers for Ralph Lauren's physical merchandise are varied. For some of its items (such as Blue Label), the market is fragmented with many suppliers from all over the world. For other, more specialized items (such as Collection) there are fewer vendors that can produce the quality that Ralph Lauren demands.

What we inferred from this framework is that while the e-luxury industry is growing, significant profits should be attainable for most participating companies – it is an attractive industry.

However, as the industry matures, differentiation will become more and more of a key factor to sustaining better-than-average profitability. For luxury companies, a key differentiating factor is the brand image. This model further supports the importance of elevating the brand as a priority for Ralph Lauren; investigating how to elevate the brand was our next logical step.

6. SYSTEM DYNAMICS – A RELATIONSHIP PERSPECTIVE

Once we identified the positive and negative factors within the luxury e-retail market in South Korea through strategic framework analysis, we then sought to identify the behaviors between critical variables that Ralph Lauren could influence.

6.1 Exploring the Critical Behaviors of Sales and Operations

System dynamics models are aimed at analyzing a problem – the thought model we are trying to produce will help analyze the problem of elevating the brand as it pertains to other variables in

South Korea. With an understanding of system dynamics notation, we started investigating a simplified Causal Loop Diagram (“CLD”) for Ralph Lauren’s brand image and demand in South Korea as seen in Figure 5.

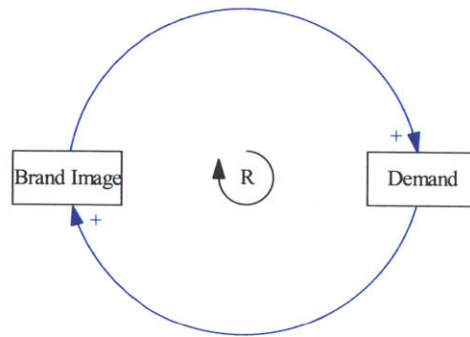


Figure 5: Simple CLD for Ralph Lauren – Brand & Demand

The link between brand image and demand is generally applicable in the luxury business world: the higher a company’s brand image is, the more its products are demanded. The more its products are demanded, the higher its image becomes. This concept is central to Ralph Lauren’s strategy for operating in South Korea – but the variables that affect brand image required further investigation. When producing a system dynamics model, the first step (after selecting a problem to investigate) is to try to generate a list of key variables that interact in the system. (Sterman, 2010) We drew upon our research, site visits and interviews and began to brainstorm; several white-board sessions later, we came up with an extensive list of factors that could affect Ralph Lauren’s brand in South Korea:

- Marketing effort
- Store location
- Number of stores
- Size of stores
- Presentation of merchandise
- Product differentiation
- Product customization
- Customer perception of Blue Label brand
- Customer perception of Collection brand
- Customer segmentation
- Product assortment and mix
- Customer services
- Competitor merchandising
- Competitor store location
- Online demand
- In-store demand
- Collection demand
- Blue Label demand
- Stock-outs
- Complementary sales
- Available selection online
- Available selection in-store

This list, while not comprehensive by any means, was too big to attempt mapping with a CLD – it would be too complex to have any value to a user. Models such as the CLD are meant to aid in understanding by simplifying a problem or breaking it into smaller digestible chunks for analysis – so we delved into the list and broke out the critical strategic factors we believed to be most pertinent to the discussion.

- Stock-outs and Complementary Sales
- Product Assortment and Mix
- Online Sales, Additional Services and Customization

6.2 Stock-outs and Complementary Sales

One of the more interesting relationships in the luxury sector is between stock-outs, brand image, and demand. For traditional companies, a stock-out is perceived as an operational failure.

Stock-outs can be a nuisance for customers (i.e. when a vending machine is out of a particular snack) or stock-outs can be a life and death matter (i.e. when a hospital runs out of a particular medicine).

Since luxury items are meant to be unique, customized and not widely available to the masses, a stock-out can often be perceived as an element of exclusivity – and it can make the brand even more coveted. A stock-out can elevate the brand, which increases demand, which further contributes to stock-outs. The CLD in Figure 6 represents this system.

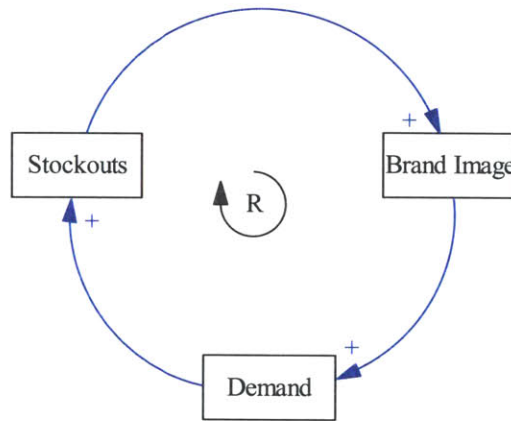


Figure 6: CLD of Stock-outs, Brand and Demand

This simple model may represent one theory driving brand image, but perhaps a more realistic model contains another variable: complementary sales.

A “complementary sale” occurs when a customer who is shopping in a retail store ultimately makes an online purchase from the store using an iPad® or other device. This can happen in two ways:

- The item the customer seeks to purchase is out of stock in the store, but the sales associate is able to convert that sale to an e-retail sale by using an iPad or other mobile device to enter the customer’s order at that moment.

- The sales associate is able to suggest to the customer an item that is offered only through e-retail, which the customer otherwise would not have known about. Since floor space in the retail stores in Korea is so limited, this is a likely scenario to occur. There wouldn't be any way to display or stock in a store every color, size, and unique piece of merchandise that Ralph Lauren has in its portfolio – but those variations can be stored at the distribution center, and made available to customers through e-commerce.

A complementary sale will generally increase customer satisfaction and thus increase the brand image – but perhaps more interestingly, a complementary sale might induce customers to use the e-retail channel independently from their home or office in the future. For example, assume that 25% of the time a customer in a store will face one of the above situations and choose to use the e-commerce (iPad®) platform to purchase an item that is not in stock. In that case, a stock-out at the retail store would cause a complementary sale online, while simultaneously elevating the brand. An additional point to note is that complementary sales may induce future online sales as well, since customers will be familiar with the channel already, as seen in Figure 7.

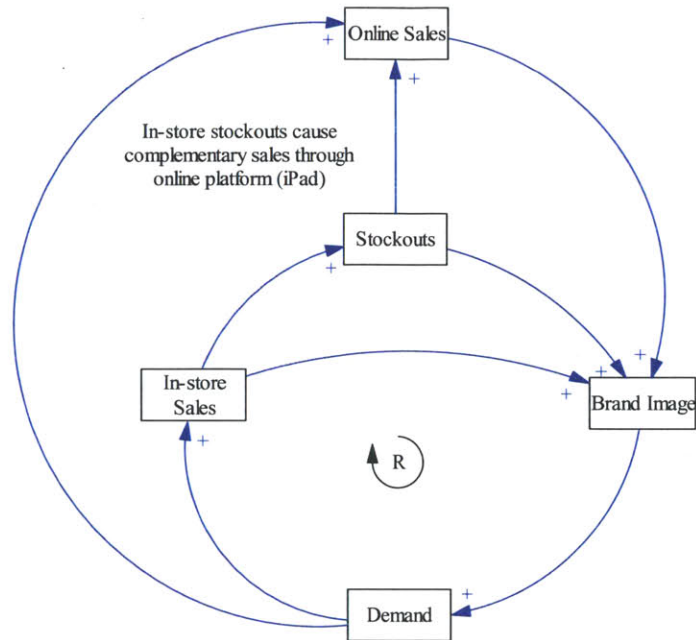


Figure 7: CLD of Brand, Demand and Complementary Sales

6.3 Moving From Product Assortment to Product Alignment

The effective use of product segmentation in pursuing e-retail can mean the difference between elevating and commoditizing the Ralph Lauren brand. But even without pursuing e-retail, we also wanted to investigate how the interaction between Collection and Blue Label demand affected brand and demand from a holistic Ralph Lauren view. In Figure 8 we map this relationship out.

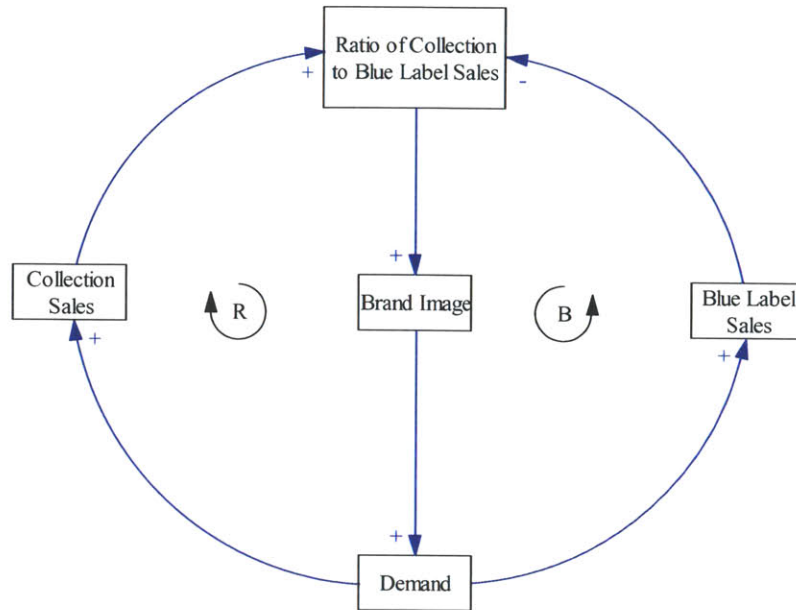


Figure 8: CLD of Collection and Blue Label Sales

This CLD implies that elevating the brand will increase demand, which will increase sales for both Collection and Blue Label items. If Collection sales are high relative to Blue Label sales, the brand image will elevate. However, if the ratio of Collection to Blue Label sales falls due to a surge in Blue Label sales (as was the case when Doosan harvested the Blue Label items in South Korea) then the brand image will suffer.

Drawing upon our conversation with the flagship store manager in Seoul, we wanted to further explore how Blue Label customers “trade up” to Collection level items by purchasing accessories. The CLD in Figure 9 (below) illustrates how strategic placement of Collection level accessories (such as watches, tie clips, charms and belts for instance) within the Blue Label assortment can magnify the CLD from Figure 8.

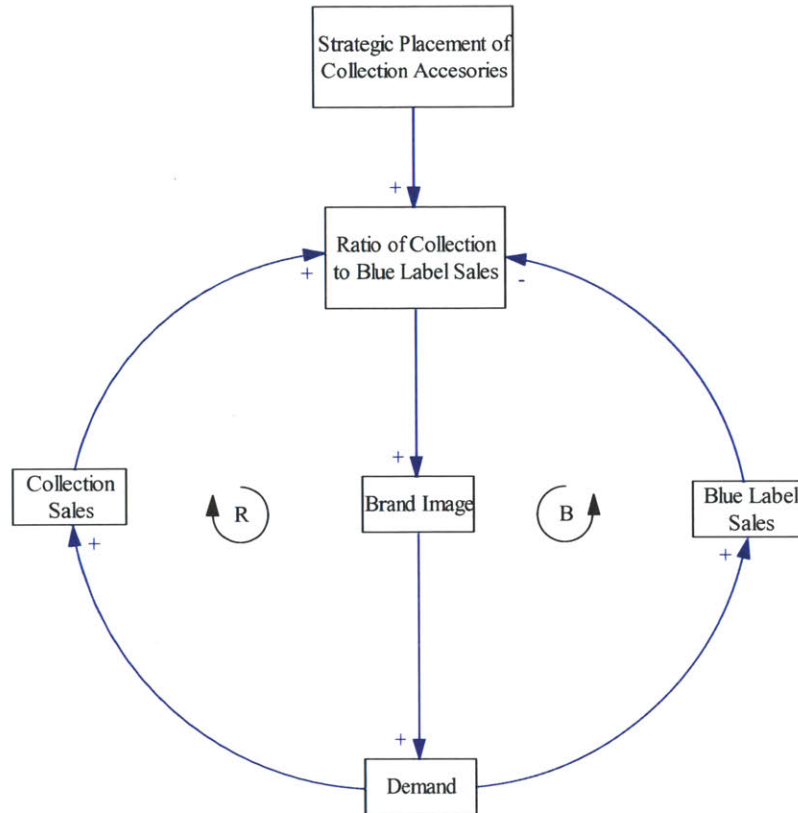


Figure 9: CLD of Collection and Blue Label Sales with Strategic Collection Placement

6.4 Online Sales, Additional Services and Customization

Online sales can create both positive and negative impacts on the brand image. This is unavoidable for both luxury retailers and commodity retailers such as Amazon. Online customers will always face mediation (since they touch the physical product) and a time delay between purchase and receipt of goods. However, luxury companies face the additional burden of losing the appearance of exclusivity when they sell online. On the other hand, e-luxury also presents the opportunity for retailers to tell an “online story” – where they bring customers into the luxury lifestyle and brand – as well as providing additional fulfillment services. In some cases, such as when a customer places an online order from a store, luxury retailers also have the

opportunity to provide immediate gratification to the customer – which will elevate the brand. We illustrate these relationships in Figure 10.

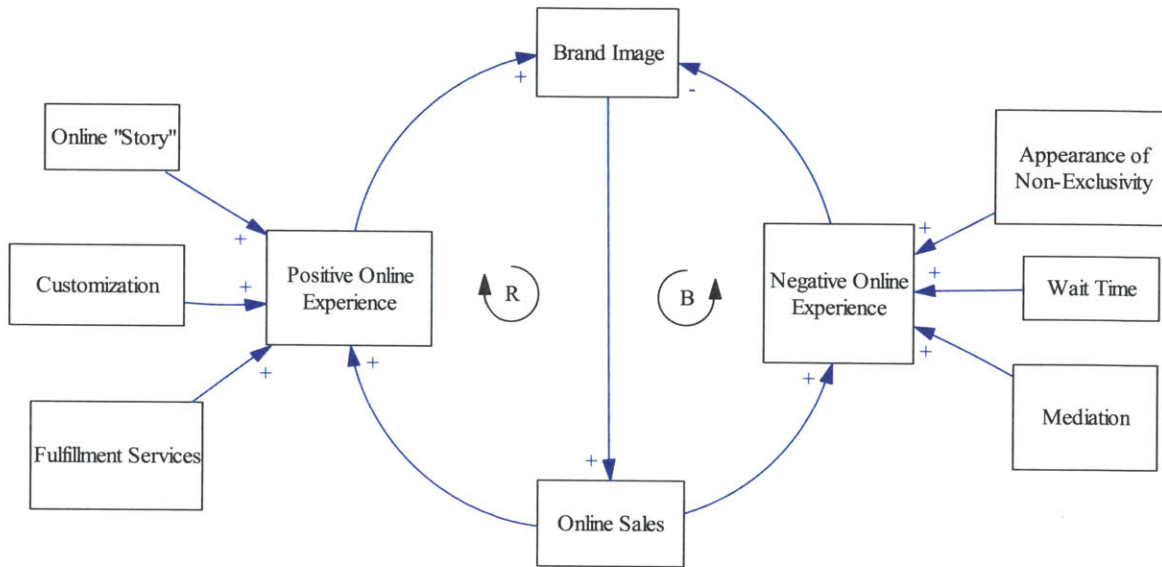


Figure 10: CLD of Positive and Negative Online Experience

Finally, customization capabilities (such as those that exist at Ralph Lauren U.S.) can further enhance the positive online experience as well as directly affecting brand image – South Korean customers are increasingly seeking differentiation.

The previous CLD's are just a few microcosms from a larger and much more complex system, with countless more uncertainties. To reiterate, we used system dynamics as a thinking tool to approach Ralph Lauren's challenge of elevating the brand while introducing e-retail.

7. DISCUSSION

7.1 Defining the Strategy

Ralph Lauren has two concurrent goals in South Korea: to elevate the brand, and to enter the luxury e-commerce market. To achieve these goals, the strategy Ralph Lauren employs will have to address the positive and negative factors presented in the Porter's Five Forces and SWOT frameworks by controlling the behaviors presented in the system dynamics analysis. Porter's Five Forces analysis indicates that overall, the market is ripe for Ralph Lauren to pursue e-luxury, but there are some obstacles to overcome. SWOT analysis brings to light some of the specific weaknesses and threats that Ralph Lauren will have to address.

As the luxury market matures, competition will intensify. These competitors are skilled at replication, benefit from the brand damage done by the Ralph Lauren licensee, and use discounting heavily. E-luxury can provide a competitive advantage if implemented well, but Ralph Lauren must "swim upstream" in a largely traditional, department store oriented market. For these reasons, Ralph Lauren must not only elevate its brand, but also differentiate itself from competitors and move ahead of the shift toward non-traditional luxury buyers.

The core strategy that we recommend involves three key guidelines. The first is to (1) **unify the Ralph Lauren experience**. Whether in-store or online, Collection or Blue Label, brand image should be consistent and built around "Ralph Lauren lifestyle". Every clothing line should fill a different gap in the customer's life – every product display reinforcing the others. While unifying the image from the customers' perspective, the second guideline is to (2) **segment the services and operations** by customer requirements – including but not limited to: product

information, support, fulfillment services, inventory position, and customization. Michael Porter, the creator of the Porter's Five Forces framework, calls this *needs based positioning*. Finally, the third guideline is to (3) use **“Collection” to differentiate and anchor the brand**. These high-end, unique items – and the luxury services afforded to Collection customers – are Ralph Lauren's strongest link, and are extremely difficult for Blue Label competitors to reproduce. These “Collection-centric” efforts should be highly visible to Blue Label customers, whenever possible.

Using what we inferred from Porter's Five Forces and SWOT analysis, as well as the systems thought models, we sought to answer questions using the above strategies to remove obstacles and exploit opportunities.

7.2 What is the effect of stock-outs on brand and demand?

Ultimately, the economic aim for all retailers is to match the supply of product with the demand of customers at a given price point. However, because of the uncertain nature of demand, retailers must take an “inventory position” – or the amount of product in stock at a retail store in relation to expected demand. For example, a product with a high inventory position would rarely, if ever, stock out. The luxury industry normally chooses a low inventory position, often driving demand higher because of the uniqueness of the product.

At Ralph Lauren, the relationship between stock-outs and overall brand image varies not only by label, but also by product category within each label. Figure 11 below demonstrates the relationship between strategically optimal inventory position and price point:

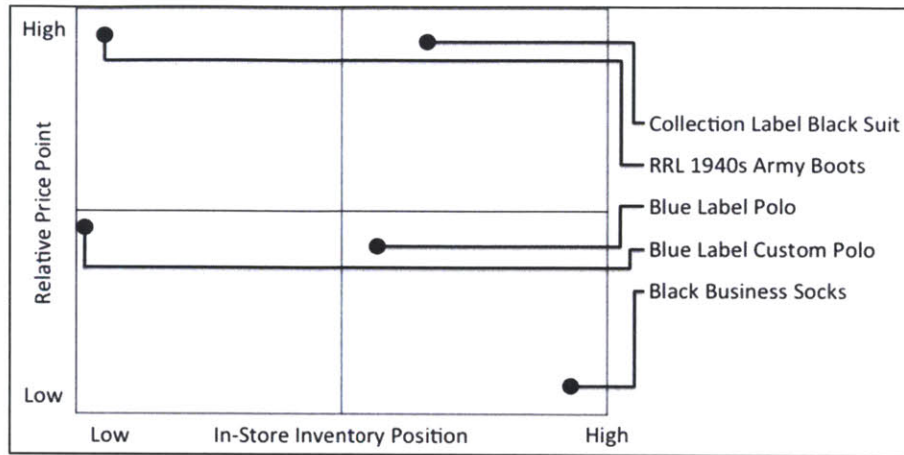


Figure 11: Relative Price Point vs. In-Store Inventory Position

Products near the perimeter of the grid have a more intuitive strategic placement. For example, customizable Polo “blanks” will always have a zero in-store inventory position, assuming the customizing station exists off-site. Similarly, unique vintage items (such as the RRL restored boots) can only have a low in-store inventory position.

Because of limited floor space and small or non-existent backrooms, the tradeoff between Collection and Blue Label in-store inventory position requires a bit more thought. In the past, the licensee opted toward lower margin inventory because of their preference for high-sales velocity, which hurt the brand image. By shifting to a stronger inventory position of Collection and one-of-a-kind items, Ralph Lauren can counter the threat of high Blue Label competition identified in the SWOT analysis.

Collection Label items also warrant a high inventory position for a number of other reasons. Relationships with high-end customers benefit greatly from the expertise of store Managers, who are knowledgeable about the subtle intricacies of product quality and design. These relationships, as well as the luxury services and ambiance that accompany the in-store shopping experience, shift customers away from price-sensitivity. Many Collection items have the benefit

of “timeless style,” meaning that they are able to remain in store inventory for a long period of time without “expiring” due to change in fashion or season. Finally, Ralph Lauren benefits greatly from Blue Label brand elevation provided by well-managed Collection Label sales, a relationship we will explore further in section 7.3.

At the same time, the floor-space limitation imposed on Blue Label items by increased Collection Label and unique-item inventory can be overcome using “omni-channel sales”. Omni-channel seeks to create a seamless customer experience across channels. For Ralph Lauren, this involves the utilization of in-store iPads (or similar devices) to order products directly from the DC to a customer’s home; it has been employed successfully in the New York flagship stores. Omni-channel sales also provide Ralph Lauren an opportunity to create an “online conversion” – the benefits of which we will discuss in section 7.4.

7.3 What is the effect of Collection sales on brand and demand?

In the previous section, we recommended that Ralph Lauren stock a higher proportion of Collection Label items in-store, while maintaining Blue Label sales through omni-channel retailing. To better understand the effects of this operational change, we created a simple model that simulated the system dynamics CLD portrayed in chapter 6.1.2.

As we explored the relationship through our system dynamics model, several demand patterns became apparent. The four most pertinent are broken out below:

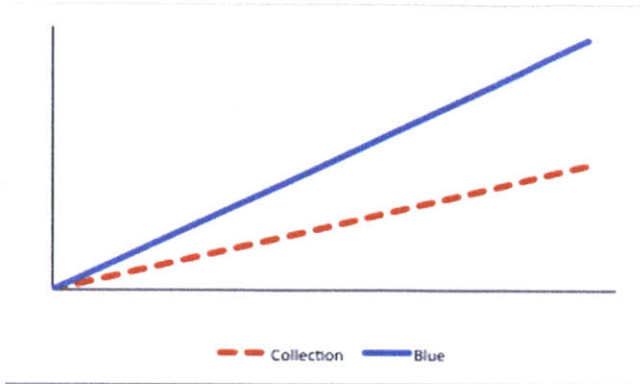


Figure 12: Multiplicative Demand

Overall demand grows linearly, and the ratio between Collection and Blue label demand stays constant. This pattern emerges when demand for both apparel lines are dependent on an outside independent variable or variables.

Operational examples include **new store openings** and the **geographic coverage of e-commerce** (assuming that the pool of new consumers has a similar demand composition to previous consumers).

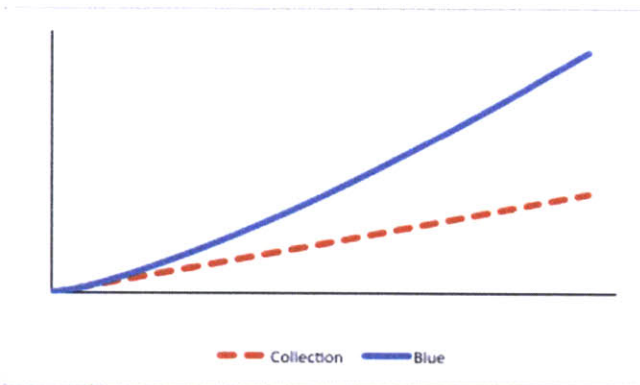


Figure 13: Exponential Demand

Demand for Blue Label grows exponentially as Collection Label demand increases. This is due to increasingly positive brand image associated with Collection sales, assuming a strong relationship between labels due to high visibility.

Operational examples include **targeted luxury marketing** and **celebrity/sports figure endorsements** that leverage luxury to enhance brand power.

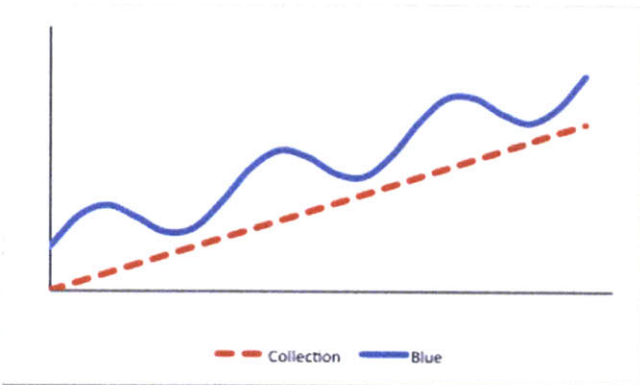


Figure 14: Ratio-Dependent Balancing Loop

Demand for Blue Label grows exponentially as Collection Label demand increases until it is limited or reversed due to increasing apparel commoditization. This behavior assumes that Blue Label demand is a dependent function of independent Collection demand.

Operational examples include **product life-cycles** and **competitor substitution** (in a price sensitive market).

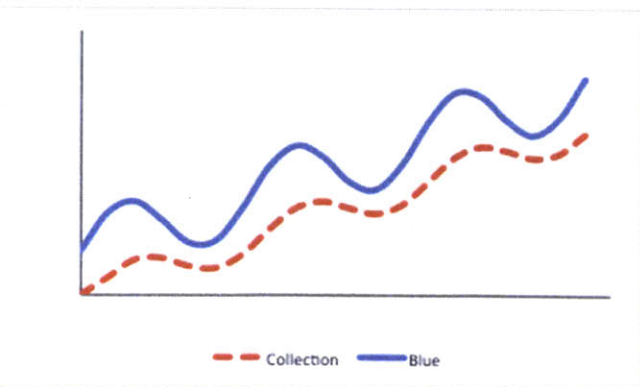


Figure 15: Cross-Correlated Balancing Loop

Similar to the *ratio-dependent balancing loop* behavior, this behavior assumes that the demand for both Blue and Collection Label items balance to maintain a “luxury appropriate” ratio.

Operational examples include **discounting** and **brand harvesting**, in which brand image is damaged due to a high-production or high-volume sales model.

The first two behaviors, *multiplicative demand* and *exponential demand*, are positive behaviors when seeking to elevate the brand, while the latter two behaviors are negative. The positive behaviors attribute to growth and reflect the reinforcing loops seen in Chapter 6. The negative behaviors reflect the balancing loops that limit growth. Ralph Lauren can influence these behaviors through strategic use of SKU and customer segmentation, as well as alignment of IT, marketing and supply chain around the common goal of “elevating the brand”. These are strengths that Ralph Lauren can leverage as described in the SWOT analysis.

Because Korea has such a high population density and adequate coverage by stores, multiplicative demand growth due to geographic expansion should not have a strong effect in South Korea. This is true of both brick-and-mortar and e-commerce expansion. Most likely, overall demand growth will be attributed to the increasing Korean wealth and demand for luxury goods. This may not only lead to higher sales volume, but also a higher proportion of Collection buyers, and a shift in the composition of the luxury market away from the “traditional core”.

One such shift appears to be toward younger luxury shoppers. A McKinsey survey of the South Korean luxury market in 2011 noted that luxury sales at the Shinsegae department store rose at an annual rate of 74% for shoppers in their 20s, compared to a meager 9% for shoppers in their 50s and 60s. Another McKinsey study in 2010 noted that younger shoppers also spend a higher proportion of their income on luxury goods. (A. Kim, 2011) Ralph Lauren’s inventory should reflect this change toward more active, “on-the-go” lifestyles in both work and play.

Moreover, a rising percentage of these young buyers are professional women. The number of Korean women making over 100 million Won increased by 10% in 2008, twice the rate of men – a significant trend considering that women make 90% of luxury purchases. These young

professional women often desire high-end accessories to compliment business or business-casual attire. Indeed, luxury accessories saw the most growth (10-30%) out of any luxury category in 2009. (Salsberg, 2010) Another important shift is toward men using the e-commerce channel. The McKinsey study noted that the 29% jump in male luxury buyers was largely attributed to better channel accessibility making shopping easier. 73% of male survey respondents selected “It has become more convenient to purchase luxury goods” when asked what led to their increased luxury spending. (Salsberg, 2010) We will discuss specific effects of e-commerce more in section 7.4. Whereas multiplicative demand is essentially the overall expansion of sales and operations, *exponential demand growth* is the increase of Blue Label demand because of increased Collection demand. More specifically, it is the effect of *high-visibility* Collection items and services creating excitement among Blue Label buyers. During our visit to the RRL store in New York, we noticed that the careful placement of unique and high-end accessories among the casual apparel created visually stunning displays, and created an environment in which customers could be inquisitive and conversational with the affable Ralph Lauren staff.

While separate product placement of Collection apparel from Blue Label may benefit the Collection image, we recommend the careful placement of high-end accessories into Blue Label product displays – both online and in-store. Because the core strength of Ralph Lauren is the ability of its team to create a unique, high quality, luxury lifestyle for its customers, this product mixing will be hard to replicate for both “copycat competitors” and the counterfeit market.

Ralph Lauren may place very high quality and unique items next to Blue Label items with targeted precision; attempts to replicate the product mix will be difficult and likely ineffective.

The *ratio-dependent balancing loop* behavior occurs when the exponential growth of demand for Blue Label items is limited by high-volume sales and subsequent disassociation with the luxury

brand. Essentially, Blue Label “takes over” the brand image, and the high visibility of Collection sales is lost. This behavior assumes that Collection sales remain tightly linked with service and quality, and are not affected by the fluctuation of Blue Label demand. If high-end lines *are* affected by the popularity of mid-line merchandise, demand can take on the behavior of a *cross-correlated balancing loop*. This is very concerning for retailers because the fluctuations in demand are intensified, and competitors are able to gain ground. This is true in the case of “brand harvesting”, where licensees utilize high-volume marketing, sales, and inventory strategies that detract from the Collection image and are not aligned with the goal of brand elevation.

Ralph Lauren can do many things to control these negative behaviors. Simply raising prices to control sales volume may increase grey-market, replica, and copy-cat sales. Creating a targeted product mix of high-end and unique items with Blue Label items should effectively “anchor” Blue Label sales to more consistent Collection Sales. At the same time, this product mix (and more importantly, the expertise of Ralph Lauren to put the mix together) will be hard for competitors to replicate. Collection sales will be driven by innovative luxury services that we will discuss further in section 7.4.

7.4 What is the effect of online sales on brand and demand?

Ralph Lauren Corporation has two core strengths over its competition: it is able to create apparel, accessories, and home furnishings that define the luxury lifestyle image, and it knows how to warmly welcome the customer into this lifestyle and maintain a loyal relationship. Customers come to Ralph Lauren for the experience of luxury shopping and to find items that make them feel like they are a part of the luxury Americana tradition that Ralph Lauren embodies; this is as

true online as it is in-store. The success of e-commerce to strengthen customer demand and purchasing pride in South Korea depends entirely on the ability of the company to impart this effect through the online channel.

There are a number of benefits of introducing e-commerce, but these benefits are only realized if service and experience at these points are both high quality *and* seamless across all channels, like a well-orchestrated performance. Darrell Rigby (2011) of the Harvard Business Review summarized the importance of omni-channel retailing in today's market. He explained that "most retailers think of themselves as primarily physical or online, with just a few thinking far beyond that to creating a fully integrated approach to the customer experience. 'Clicks and bricks' (the separation of in-store and online sales) is a highly dated view in a world where there is continual channel proliferation." (Rigby, 2011)

Often, retailers choose to implement e-commerce in order to virtually expand their service area, thereby growing their market by reaching more potential customers. When geographic expansion is their primary goal, retailers often service online customers with dedicated fulfillment centers to service customers. The online channel may be controlled almost completely separately from brick and mortar operations, which can be a detriment to other more strategic initiatives. Ralph Lauren is first and foremost strategically centered on elevating and carefully managing their brand, and therefore must provide a unified omni-channel sales experience. This is a strength that Ralph Lauren possesses, as indicated in the SWOT analysis.

After the introduction of e-commerce, there will be three points of contact between Ralph Lauren its customers: *in-store*, when browsing *online*, and *at point of fulfillment*. Each of these points of

contact provides a valuable opportunity to elevate and differentiate the brand through innovative customer services.

7.4.1 In-Store Experience

When the consumer comes into the store, not only should they experience all the benefits of the traditional brick and mortar ambiance – they need to experience a highly integrated omni-channel sales and marketing strategy.

As we mentioned in the previous section, the move toward a proportionally higher in-store inventory of Collection items requires the use of omni-channel sales, as it removes the limitation of store space by giving store managers direct access to distribution center inventory. More importantly, it provides yet another opportunity for Ralph Lauren to make an impact on its relationship with the customer. For example, the salesperson could give a small but meaningful gift to the customer for using in-store e-commerce. This elevates the brand, creates positive word-of-mouth advertising, and puts e-commerce in a positive light. The items used for these “gifts” should be small enough to have plenty of units in-store, but they could be limited quantity, single production, unique and differentiated Ralph Lauren items – more in line with a Collection charm or tie clip than a Blue Label key chain – to send a message of exclusivity. These small gifts could also be differentiated and segmented according to the customer. To apply an e-commerce theme, perhaps an appropriate item to give away might be a Ralph Lauren branded iPhone® case, laptop or iPad® sleeve, or other mobile device accessory.

The use of omni-channel sales will also give Ralph Lauren enhanced inventory flexibility. For example, online orders for Collection items can be “routed” to store managers, who can ship Collection items directly from the store. Ralph Lauren associates can offer customized designs,

monograms, and colors right on the sales floor. Large items, such as furniture, can be sold in the store and shipped the very next day to the customer's door.

One possible obstacle of omni-channel sales is the time and hassle it takes to set up a new on-line customer account in-store. Store associates can defer this hassle by simply asking the customer for minimal information – a credit card to complete the purchase and an email address for the receipt. This of course would be up to the customer (the option of a paper receipt would still exist). The customer could reference the receipt to obtain their new Ralph Lauren customer account number – or if they are existing Ralph Lauren account holders, the email address can be linked via a reference number on the receipt.

7.4.2 Online Experience

In order to evaluate the important strategic variables of the e-commerce channel, it is important to understand the motivation for users to shop online. E-commerce is primarily used by retailers to expand geographic coverage, decrease shopping time, and encourage the “viral marketing effect” in order to gain new customers. However, as a luxury brand, Ralph Lauren has customers with a slightly different but related set of motivations.

Geography – The geographic distribution of the South Korean population is unique. The population, and more specifically the target luxury market for Ralph Lauren, is clustered in Seoul, as seen in Figure 16. Currently, Ralph Lauren stores provide good coverage of this area, and both distribution of inventory from the DC to the store and fulfillment of online orders take just one day.

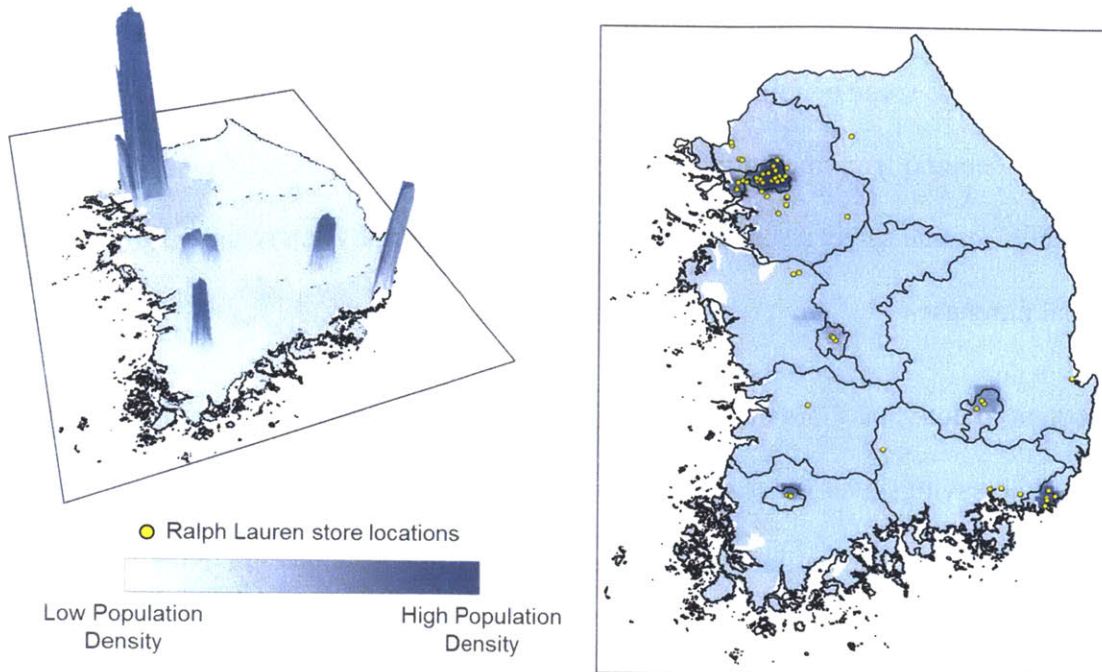


Figure 16: Population Density Map of South Korea

E-commerce provides a major advantage to Ralph Lauren, not by expanding the square mileage of its service, but rather by virtually expanding the “square footage” of the stores. In the previous section, we noted that Ralph Lauren must prioritize the Collection label image, while maintaining access to Blue Label inventory. Part of this tight integration of brick & mortar and e-commerce involves bringing the website into the store. This can be done in numerous, creative ways such as tablet computer sales, clothing customization, and “in-store consultation”.

The role of omni-channel distribution is only strengthened because of the high population density and low lead-time, as it allows a relatively good alternative to the instantaneous nature of in-store shopping. This is only amplified by the equally speedy returns. Considering that this low lead time is attained with relatively low investment, Ralph Lauren should focus on the IT systems that enable *in-store orders* and *shipment-from-store services*.

Time Savings –Despite the strong “department store culture”, the timesaving effect of e-commerce may have some benefit to Korean customers. In fact, even if there was hypothetically no increase in demand from the online channel, the Korean customers we spoke to still routinely “window shop” online to get a sense of what they want before physically travelling to the store for the final purchase.

It is important to note that there may be a detrimental effect on brand image if the website prioritizes time-savings over purchasing experience. Companies like Amazon aim to make the shopping experience as streamlined an experience as possible through “one-click” purchases, and minimalist website design.

Because the luxury brand relies on shopping experience, Ralph Lauren optimally should lead the customer through a grand experience, while at the same time maintaining purchasing ease. The high broadband penetration provides unique opportunities for the design of the “online storefront”. For example, Louis Vuitton’s website presents a multi-media experience for every product line that bombards the senses through music, video and interaction. This is the online representation of what is considered a best-in-class luxury lifestyle company. (Roberts, 2011)

Viral Effect – The viral effect of e-commerce involves leveraging technology to build value among the tight social networks that exist in Korea. Many Korean shoppers we spoke to belong to online fashion groups, read fashion blogs or magazine sites, or simply receive linked recommendations from friends.

Again, South Korea provides a unique opportunity due its high population density. Ralph Lauren can, once again, merge the online experience with the in-store experience through multi-channel marketing initiatives, such as the following:

- Online fashion clubs and forums
- Online fashion shows
- Golf celebrity signings and sponsorships
- Exclusive and tiered site membership
- Birthday and other gift items
- “Design-your-own” gift cards
- Corporate integration

This last point – corporate integration – refers to creating relationships with companies, where knowledge of promotions or other celebration-worthy events leads to a personalized experience at Ralph Lauren. The idea stems from the fact that South Korea is extremely “status oriented” and highly respectful of leadership, authority and success. Ralph Lauren might be able to connect directly to a company’s HR department and coordinate unique services through an online portal. For example, a newly promoted business leader might get a personal invitation to the store celebrate their promotion with a private Ralph Lauren fashion consultation and perhaps a free monogramed shirt. The goal is to create a memory and a relationship with a potential Collection client.

7.4.3 Point of Fulfillment

While the online channel replicates the in store experience, it cannot recreate the experience of touching soft fabric for the first time, or walking out of a store with a new outfit. Choi (2006) described the “mediation” factor, saying that “an e-commerce customer faces mediation in every element and at every stage of the commerce transaction. Customers can’t see the merchant, but only the merchant’s website; they can’t touch the merchandise, they can only see a

representation; they can't wander a store and speak with employees, they can only browse HTML pages, read FAQs, and fire off email to nameless customer service mailboxes.” (J. K. Choi et al., 2006) E-commerce must contend with mediation between customer and item, until the point that they come together – which is fulfillment.

Ralph Lauren knows this well, making sure that high end boxes are used for all deliveries, and that every bow is tied by hand. In Korea, there is even more opportunity to create a luxury fulfillment opportunity because of the relatively small area of delivery, and the potential for enhanced services such as:

- Black car service
- At-home consultations
- No-expiration and free-shipping return policy
- Payment upon delivery

Since Ralph Lauren has identified Korea Express as a likely parcel carrier to handle its deliveries, the biggest opportunity to recreate the full luxury experience is through packaging and black car delivery for appropriate customers and appropriate orders. At the Seoul flagship store, there is a black car service. Most of the time, this car would be used to enhance the luxury experience of clients who make purchases in-store. One thought is, with careful coordination, to use the black car to fulfill local Collection orders when it is not being used. This would help create a luxury experience across multiple channels by leveraging an existing asset.

8. CONCLUSION

In South Korea, the luxury market is growing and its customers are evolving. The number of young luxury consumers is on the rise, and their values, communication channels, and service demands are different than older luxury consumers. Korean luxury consumers no longer attach themselves to a brand simply because of its name or country of origin. Customers seek more and more differentiation and are yielding their loyalty to the brands that can provide the most customization, superior service, and highest value. Korean customers seeking value will also be price-sensitive shoppers – which can be a huge challenge for luxury retailers who don't use discounting as a sales lever. In the particular case of Ralph Lauren, a major obstacle is reversing the damage done to their image by its licensee, who harvested the brand over the past decade.

For companies like Ralph Lauren, success or failure in a particular market is heavily reliant on brand image. The opportunity for growth is huge in South Korea, but to capture this potential, Ralph Lauren will have to differentiate itself and elevate its brand. Managing a brand image can be extremely challenging when dealing solely with a brick-and-mortar retail operation; this challenge is intensified when luxury companies introduce an e-retail channel. When e-retail is initiated, luxury companies can face rejection from customers who see this as a commoditization of their merchandise. Understanding how different factors such as e-retail, inventory strategy, and additional services affect brand image can help luxury companies optimize their supply chain and gain an edge over their competitors.

This thesis suggests several pertinent questions, as well as their possible answers, about how a luxury brand in South Korea might be affected when e-retail is introduced. By analyzing e-luxury from a systems perspective, we were able to gain insight and prescribe several actions that

could help Ralph Lauren elevate their brand. These insights could help Ralph Lauren realize the full potential of the Korean Luxury market – both online and offline.

The relationship between stock-outs and overall brand image varies not only by label, but also by product category within each label. Since floor space in the South Korean stores is extremely limited, higher-end Collection items, as well as unique or stand-alone merchandise (vintage refurbished items) should get priority stocking in-store. A strategic selection of Blue Label items should be co-mingled in the brick-and-mortar store among the high-end SKUs – particularly the accessories. This should not only elevate the Ralph Lauren brand as a whole, but also create aspirational demand for Blue Label customers to “buy up” to the Collection level.

There is a clear opportunity for the e-commerce platform to enhance store operations – providing a virtual stock room for store associates to fulfill demand from. iPad’s ® or similar tablets can be used to complement the limited assortment on-site. Store associates can provide greater service to customers by giving them the opportunity to customize their merchandise as well as their delivery details. Website design should mirror the experience of the brick-and-mortar operation. The site should not only tell the story of the brand, but also segment out merchandise according to customers. For example, Collection customers who enter the Collection portion of the website should also have easy access to most Blue Label merchandise, because they are likely to “buy down” to Blue Label fairly often. However, the Blue Label segment of the site should only strategically display certain Collection Label items (like accessories) – to elevate the attractiveness and inspire demand for the Blue Label items, while not harming the Collection image.

Complete integration of the customer experience should be part of Ralph Lauren's everyday operational practice. "Clicks and bricks" cannot be thought of as separate business units, but rather pistons in the same engine that drives brand image. Just as e-retail should try to bring the "store experience" online, the brick-and-mortar stores should try to bring e-retail into their daily operations in a way that is consistent with Ralph Lauren's goal of elevating the brand. Store associates should leverage the broad SKU assortment available at the central DC to enhance their customer service capabilities. Behavioral drivers should be in place to reward store associates for creating an online sale (similar to Store-Net in the U.S.). If the customer makes an online purchase from a Ralph Lauren store, the mediation they experience can be mitigated by giving the customer a tangible item to walk out with. These items might be small (so that several can be stocked in a store) but they should not be worthless trinkets. Single batch, unique accessories that customer find value in will elevate the brand image and eliminate mediation.

Ralph Lauren should leverage IT enhancements and social networks to tap into the "viral effect" of e-commerce, but be careful to avoid marketing hazards in the blogosphere. Marketing should be honest and consistent and convey the brand image and lifestyle they want to attain. All of the systems and networks should enable Ralph Lauren to create personal relationships with customers while telling the story of the brand.

Overall, our analysis of the e-luxury opportunity in South Korea is positive. We agree that Ralph Lauren has synergies to be achieved by bringing e-retail to the traditionally brick-and-mortar business, and the market is ripe for implementing such a strategy. We found several mutually reinforcing factors that seem to indicate Ralph Lauren is perfectly positioned to drive towards its twin goals of elevating the brand and introducing e-retail. It will be interesting for supply chain professionals to further analyze this initiative as it rolls out in South Korea and across Asia, and

we look forward to re-examining Ralph Lauren's position a decade from now to see how e-luxury has played out.

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