

# The Impact of COVID-19 on Hermès and its Response

Wenxin Xia<sup>1,\*</sup>

<sup>1</sup>School of University of Glasgow, United Kingdom

\* Corresponding Author Email: 2607806x@student.gla.ac.uk

**Abstract.** In the face of the sudden epidemic, the luxury industry was caught off guard and suffered a major blow. This article takes Hermès as an example to study the impact of COVID-19 on luxury brands and their response to the crisis, aiming to explore the future of luxury brands.

**Keywords:** COVID-19, Hermès, Luxury Goods

## 1. Introduction

Luxury is defined as a product that has a brand premium, is of high quality, offers real value in function or emotion, has a premium reputation in the market, and resonates with consumers. [1] Generally speaking, the use value of luxury goods is limited, and the highlight is its intangible brand value. It is a consumer product for a minority of elites in society and cannot be popularized in all social strata. However, in recent years, luxury goods have become democratized and popularized. Many young consumers have relegated the functionality of goods and services to a secondary position, and are more inclined to conspicuous consumption, comparison consumption, degenerate consumption and so on.

As a top luxury brand and a family business that has been passed down for 6 generations, Hermès has a history of 180 years and has 311 stores in 45 countries around the world. The legendary long history and impeccable quality have become the brand label of Hermès. Known by the industry as "the ceiling of the luxury industry", people often compare some top products to "Hermes in the × × field".

On March 15, 2020, due to the spread of COVID-19, to ensure the health of its employees, Hermès announced the closure of all production sites in France, involving around 40 manufacturers and tanneries. Previously, Italian luxury brand Gucci has closed its factories in Tuscany and Marche, Italy, and said that due to the continued escalation of the health crisis, the closure period may be extended in many places. On March 18, Chanel also closed all production bases in France, Switzerland and Italy for two weeks.

To make matters worse, people spend more time staying at home, go out to eat and socialize less, the demand for clothing and bags has dropped sharply, and consumption tends to be "pragmatic". The luxury market is facing unprecedented darkness.

The second paragraph analyzes the financial situation of Hermès in 2020, comparing it with the situation in 2019 before the spread of covid-19, and analyzes the performance of the company in the stock market. The third paragraph specifically describes Hermès' response during covid-19. The final paragraph summarizes the research and looks to the future of luxury.

## 2. Financial Statement

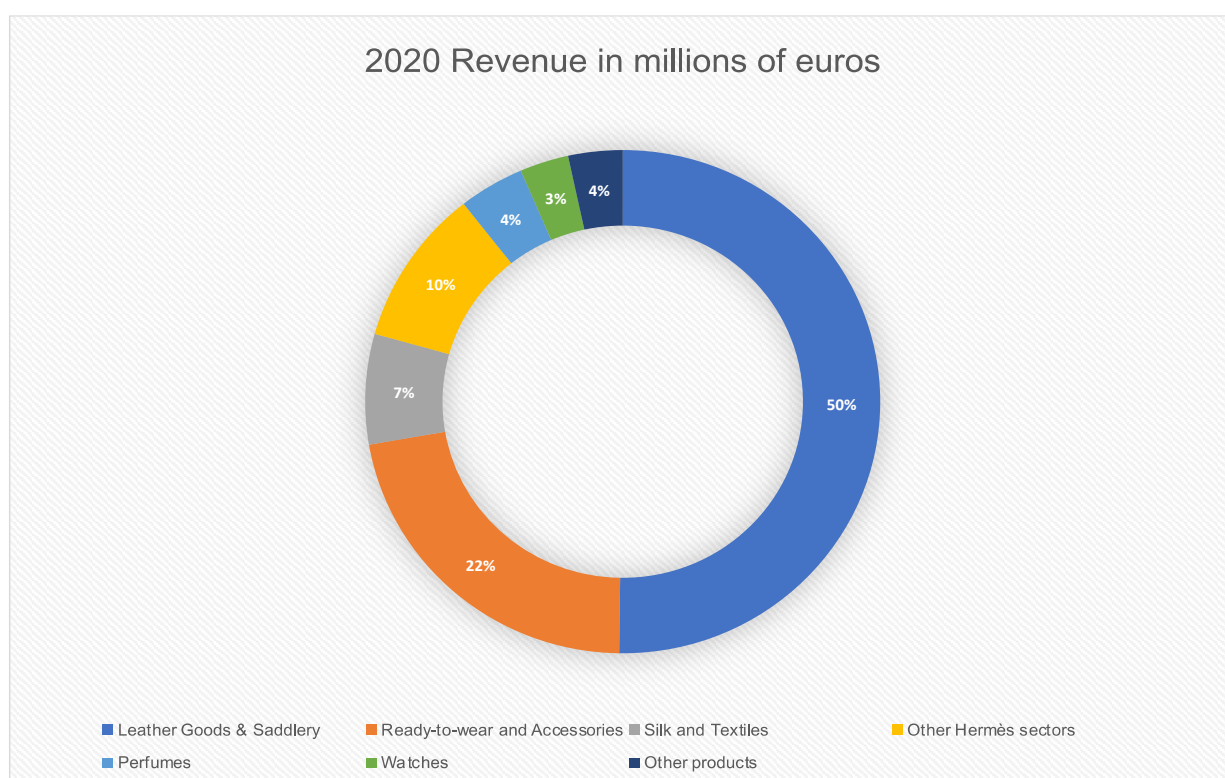
### 2.1. Income Statement

Covid-19 has led to the closure of Hermès stores in various regions of the world, and stores in some regions have been closed for nearly half a year. Therefore, the revenue of Hermès stores decreased by 25% compared with 2019.

**Table 1.** Income statement in 2019 vs 2020

<i>In millions of euros</i>	<b>2020</b>	<b>2019</b>
<b>Operating Income</b>	34.3	27.3
<b>Net Financial Income</b>	1247.4	1687.2
<b>Current Income</b>	1281.7	1714.5
<b>Extraordinary Income</b>	43.5	-49.5
<b>Net Income Before Tax And Employee Profit- Sharing</b>	1325.2	1665.0
<b>Net Income</b>	1343.2	1653.1

**2.2. Revenue by Sector**



**Figure 1.** Revenue ratio by sector

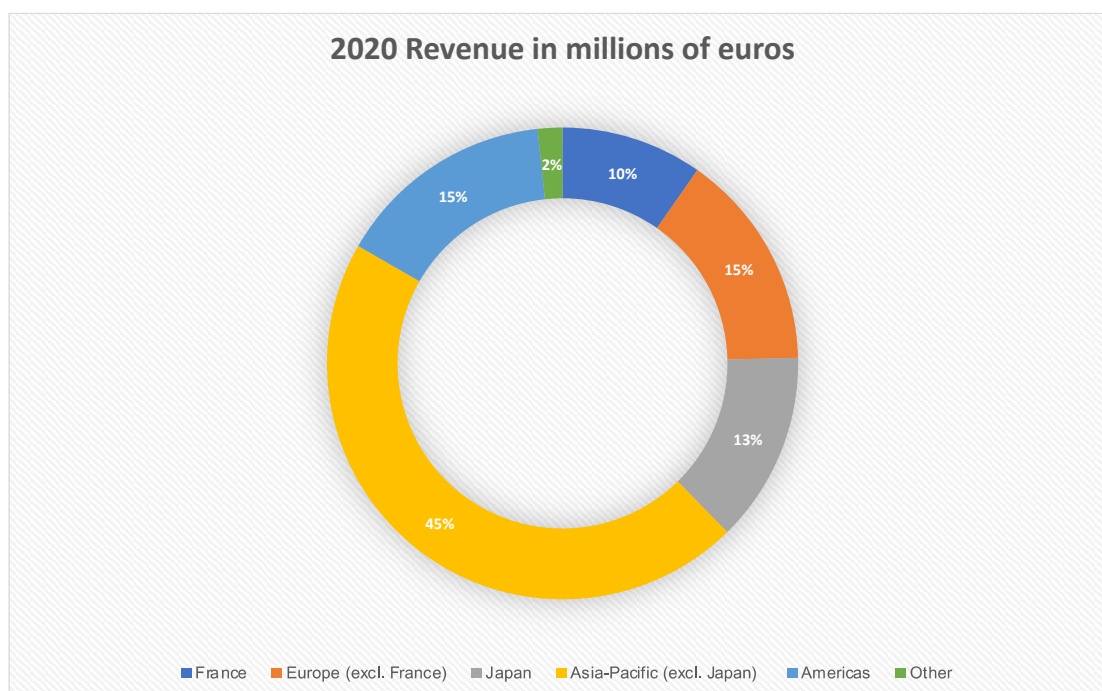
As the most popular category of Hermès, leather goods and saddlery generated 3.209 billion euros in revenue in 2020, and sales accounted for 50% of all businesses. By the end of 2020, to meet the high demand, Hermès has a total of 17 leather workshops and more than 4,000 leather artisans throughout France. At the same time, in order to maintain the high quality of products and constantly improve the craftsmanship, Hermès has an internal academy for artisans to develop their skills. It is worth mentioning that the famous Kelly and Birkin bags are the hot products sought after by buyers in Hermès. In the case of the general depreciation in the second-hand market of luxury handbags, these two bags still maintain a price more than double the starting price. Its harsh purchase conditions and pure hand-made rarity have also become its sources of high added value, requiring buyers to have a certain "brand loyalty" to obtain the qualification to buy, so the store often maintains "one package is hard to find" status.

The arrival of the health crisis in 2020 has led to factory shutdowns, store closures and a sharp decline in sales to external customers. Compared with 2019, excluding "Watches" and "Other Hermès sectors", the revenue of the rest categories are all decreased.

**Table 2.** Revenue by sector in 2019 vs 2020

	Revenue (millions of euros)	
	2020	2019
<b>Leather Goods &amp; Saddlery</b>	3209	3414
<b>Ready-to-wear and Accessories</b>	1409	1574
<b>Silk and Textiles</b>	452	592
<b>Other Hermès sectors</b>	643	525
<b>Perfumes</b>	263	326
<b>Watches</b>	196	193
<b>Other products</b>	218	258

### 2.3. Breakdown of Revenue by Geographical Area



**Figure 2.** Revenue ratio by geographical area

Asia, the largest market for Hermès, generated revenue of 3.749 billion euros in 2020, with sales accounting for 59% of all regions. Among them, the Chinese market grew strongly.

**Table 3.** Revenue by geographical area

	Revenue (millions of euros)	
	2020	2019
<b>Europe</b>	1573	2069
<b>_ France</b>	620	867
<b>_ Europe (excl. France)</b>	953	1202
<b>Asia-Pacific</b>	3749	3454
<b>_ Japan</b>	834	864
<b>_ Asia-Pacific (excl. Japan)</b>	2915	2590
<b>Americas</b>	959	1241
<b>Other</b>	108	120

Due to the disruption of overseas travel caused by the epidemic, Hermes' sales in the Asia-Pacific region (excluding Japan) increased by 14% in 2020, of which sales in the fourth quarter increased by

47%; sales in the fourth quarter in Asia increased by 38.9%. In the European region, Hermès sales fell 23.6% in 2020, and sales fell 9.7% in the fourth quarter.

## 2.4. Stock

### 2.4.1 Five Factors Asset Pricing Model

According to the Fama-French Five Factors Asset Pricing Model [2], the following model is established:

$$R_{it} - R_{Ft} = a_i + b_i(R_{Mt} - R_{Ft}) + s_iSMB_t + h_iHML_t + r_iRMW_t + c_iCMA_t + e_{it} \quad (1)$$

Of which,  $R_{it} - R_{Ft}$  is the stock return - market rate of return at time t,  $SMB_t$  is the market excess rate of return at time t,  $HML_t$  is the simulated portfolio rate of return of the scale factor at time t,  $RMW_t$  is the simulated portfolio rate of return of the book-to-market ratio factor at time t, and  $CMA_t$  is the simulated portfolio return of the profit factor at time t.  $a_i, b_i, s_i, h_i, r_i, c_i$  is the regression coefficient to be fitted,  $e_{it}$  is residual.

**Table 4.** Regression Analysis Results of the fama-french five factors asset pricing model

Regression Statistics						
Multiple R	0.598076043					
R Square	0.357694954					
Adjusted R Square	0.298222264					
Standard Error	0.053352721					
Observations	60					
ANOVA						
	df	SS	MS	F	Significance F	
Regression	5	0.08560091	0.017120182	6.014440522	0.000171068	
Residual	54	0.153711691	0.002846513			
Total	59	0.2393126				
	Coefficients	Standard Error	t Stat	P-value	Lower 95%	Upper 95%
Intercept	0.00738072	0.007752877	0.951997639	0.345340065	-0.008162862	0.022924303
Mkt-RF	0.202493994	0.191041274	1.059948928	0.293885921	-0.1805207	0.585508687
SMB	-0.789387233	0.505122509	-1.562763922	0.123950176	-1.80209689	0.223322423
HML	1.341239518	0.526905	2.545505393	0.01380017	0.284858597	2.397620439
RMW	2.142526665	0.776473459	2.759304444	0.007892321	0.58579111	3.69926222
CMA	-2.515126405	0.977056876	-2.57418628	0.012823547	-4.474007499	-0.556245311

According to regression analysis:

$$R_{it} - R_{Ft} = 0.00738072 + 0.202493994(R_{Mt} - R_{Ft}) - 0.789387233SMB_t + 1.341239518HML_t + 2.142526665RMW_t - 2.515126405CMA_t + e_{it} \quad (2)$$

It can be found that judging from the performance of the past five years, Hermes stock is a stock worth investing in. The operation trend of this stock in five years is consistent with the overall operation trend of the market. It is a large-cap stock with a high book value and a very good performance, but it is volatile.

## 2.4.2 Stock Price Comparison



**Figure 3.** 2017-2021 stock price comparison from Hermès, LVMH and Kering

Comparing Hermès stock with well-known luxury groups LVMH and Kering, it can be found that the overall trend of Hermès' share price from 2017 to the beginning of 2020 is similar to that of LVMH and Kering, and from mid-2020 onwards, comparing these two stocks, there is a more obvious increase.

Many consumers like to buy luxury goods while traveling. Not only because of the price gap of overseas shopping, but also can enhance the sense of travel experience. A large part of the luxury industry's revenue comes from tourists. However, due to travel restrictions between countries due to the epidemic, for most luxury brands, this part of the income has fallen sharply. Hermès is one of the more special ones. Due to Hermès' sales model of "requiring long-term consumption accumulation to buy popular products", most Hermès customers tend to choose designated sales to buy products. As a result, Hermès consumers usually buy in their usual place of residence, and the proportion of tourists' consumption is much lower than that of other luxury brands. Therefore, when travel restrictions occur, people are more optimistic about Hermès than other luxury brands.

## 3. Responding to COVID-19

### 3.1. Internal Management

In the face of Covid-19, Hermès is maintaining all jobs and wages around the world, while doing its best to keep its employees safe. A monitoring team was established on February 28, 2020 to anticipate and support epidemic prevention efforts, including the supply of masks, gloves and wipes. As of the end of 2020, about 10 million euros were spent on personal protective equipment for employees returning to the site.

In terms of employee training, only online training courses and courses that cannot be postponed will be carried out, and the rest will be postponed to the end of the year. Employees can also access remote meetings with stakeholders through the weekly newsletter.

The board has adjusted the organization of board and committee meetings, using 100% video or hybrid meetings, and strict hygiene arrangements and room layouts.

### 3.2. Salary

The two executive chairman have forgone pay increases, so 2020 pay is the same as 2019. Axel Dumas' fixed salary in 2020 has been reduced from €1,824,677 to €1,623,378 and that of Émile Hermès SARL from €620,279 to €551,850. The 2020 variable remuneration awarded to Axel Dumas for 2019 was reduced from €1,956,269 to €1,780,045, while the Émile Hermès SARL was reduced from €912,261 to €830,083.

In addition, Hermès will pay a bonus of 1,250 euros to all employees in early 2021 for their contribution to performance.

### 3.3. Stock

As of December 31, 2020, Hermès' inventory and work-in-progress had a combined balance sheet value of 2.104 billion euros and a net value of 1.289 billion euros, representing 12% of the company's total assets.

Due to an increase in inventory due to a significant reduction in sales, Hermès decided to reduce the value of the inventory to its possible sales value. Estimated outlook for inventory allocation in different markets based on inventory status and its obsolescence, taking into account the slow turnaround of seasonal products due to COVID-19, to address inventory pressures.

### 3.4. Online Sales

The Covid-19 crisis has proven the importance of e-commerce and digital ecosystems. For example, during the four major international fashion weeks, Gucci, Louis Vuitton, Chanel and Hermes all took the form of live broadcasts.

In the past five years, Hermès has strategically increased its online sales, launched its online platform globally, attracted new customers and developed a series of service processes. Digital platforms are designed to be similar to brick-and-mortar stores. And the arrival of Covid-19 has accelerated the use of digital by customers. In 2020, Hermès increased its investment in online platforms and promoted the promotion of digital platforms in Asia in Hong Kong, Macau and South Korea. In addition, Studio des Fleurs, which provides photography and retouching services for packaging photos of e-commerce products, is considered an important related party by the Hermès Board of Directors.

While this health crisis may be a catalyst for the digitization of the luxury industry, the transition will not be easy for many luxury brands. For Hermès, for example, consumers still cannot buy Birkin or Kelly bags online.

### 3.5. Factory "Transformation"

The "chain reaction" of COVID-19 is unfolding globally. In the face of the virus, hand sanitizer has become more precious than perfume, and ventilators are harder to find than limited-edition handbags.

When all Hermès factories were shut down, only the Hermès Parfums du Vaudreuil factory was left to start producing hydroalcoholic gel. On arrival at the premises, it was mandatory for employees to use hydroalcoholic gel and donate it to partners and society. In addition, a large number of masks were donated to the society, and 20 million euros were donated to AP-HP.

## 4. Conclusions

According to Deloitte's "Global Powers of Luxury Goods 2021", the sales of the world's top 100 luxury goods companies in 2020 fell by 12.2% compared to 2019. Among them, Hermès lost 7.2%.

[3] It can be seen that covid-19 has had a huge impact on the luxury goods industry.

In the face of covid-19, Hermès regards protecting the health of its employees and consumers as its top priority and is actively involved in addressing public health needs. In fact, in addition to Hermès, most of the luxury goods companies also contributed. LVMH's three beauty brands Dior, Givenchy and Guerlain produce hand sanitizers on all production lines in France. In the first week, 12 tons of hand sanitizers were produced, most of which were provided to hospitals for free without trademarks. In addition, LVMH donated 40 million masks to France. Kering Group imported 3 million surgical masks from China to donate to French health agencies. At the same time, Kering's brands such as Gucci and Balenciaga also produce anti-epidemic materials such as masks and protective clothing. Among them, Gucci produced more than 1 million masks and 55,000 medical work clothes in Italy.

The health crisis has also exposed many of Hermès' problems. The first is the improvement of the online store model. With many stores around the world closed due to the pandemic, online communication has become a mainstream safe mode. Although Hermès already has an online platform and a series of service systems, it is not widely promoted among customers. This is related to Hermès' special consumption pattern. The second is the control of inventory levels. At the beginning of the epidemic, sales in the first quarter of 2020 fell sharply, which is normal. Due to the particularity of Hermès in luxury goods, there are fewer channels for inventory handling than other brands. It's worth thinking about how to handle inventory more efficiently while maintaining the brand's tonality. Finally, when people travel less, the frequency of social activities decreases, and the demand for beautiful clothes and luxurious bags decreases, and "desire consumption" gradually turns into "pragmatic consumption". The "functionality" of the product will be placed in an important position. Although this problem will not have much impact on the luxury goods industry in the short term, in the long run, whether it is Hermès or other brands, it should be planned early.

## References

- [1] Ko, E., Costello, J. P., & Taylor, C. R. (2019). What is a luxury brand? A new definition and review of the literature. *Journal of Business Research*, 99, 405-413.
- [2] Fama, E. F., & French, K. R. (2015). A five-factor asset pricing model. *Journal of financial economics*, 116(1), 1-22.
- [3] Deloitte. (2021). Global powers of luxury goods 2021.