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Will Coach Become Too Popular?

The stylish handbag maker had a blowout quarter. But rapid expansion may jeopardize its upscale image

by [Pallavi Gogoi](#)

Coach ([COH](#)), the maker and retailer of stylish handbags, just had a blowout season. For its fiscal second quarter, sales at stores open at least a year soared a whopping 25.7%, leading to a 31% increase in profit. Coach Chief Executive Lew Frankfort was so keyed up by these results that he boosted the number of stores the company will open this year by an additional 10, to a total of 40. "The Coach brand has never been more vibrant," says Frankfort.

But is Frankfort having a bout of irrational exuberance?

Clearly, Coach has recorded some of the best growth numbers of any retailer or accessories maker in recent years. As Frankfort pointed out in a conference call with analysts, Coach has achieved double-digit sales growth since 2001 in each holiday quarter, for a five-year compounded annual growth rate of 29%. "We've never been more excited about the potential for the Coach brand," says Frankfort.

FALLING INTO THE GAP?

And why not? Economic signs are pretty good, too. Consumer confidence as tracked by the University of Michigan is up sharply for January and the Labor Dept. reported that the unemployment rate is at a five-year low of 4.5%. That's clearly a nice setting for expansion.

Problem is, it reminds some of a similar setting in the late 1990s when the economy was roaring and Gap ([GPS](#)) was the quintessential retail success story, posting month after month of same-store sales increases. Its stock had risen 122% between 1998 and 1999, and it had increased the number of its stores by 12%, with plans of upping that to 20%. Gap could do no wrong. Dorothy Lakner, at that time an investment analyst at CIBC Oppenheimer, hailed Gap: "They've got the momentum in their favor." And Karen Sack of Standard & Poor's was so upbeat that she believed Gap could recover from any mistakes because "they don't sit still, so you have confidence that they'll think through it and bounce back—and that's what's important."

Anyone in the retail world today knows that plastering the world with Gap stores was the beginning of myriad problems. The Gap look became so ubiquitous that it lost its specialness. In just two years, it started posting sales declines. By 2002, it lost its legendary CEO Millard "Mickey" Drexler. And on Jan. 22, the company fired its replacement CEO, former Walt Disney executive Paul Pressler (see [BusinessWeek.com](#), 1/23/07, "[CEO Wanted: Gap's Search for a Savior](#)"). "Ubiquity can be the death of a brand," says Robert Passikoff, CEO of Brand Keys, a New York brand consultancy. "You

need to be very careful when you expand."

FOR UPSCALE, IMAGE IS EVERYTHING

Coach beat Wall Street analysts' estimates in its fiscal second quarter, with overall revenues climbing 29% to \$836.4 million and profit rising 31% to \$227.5 million. However, a close look at the sales numbers reveals that the gains came mostly from its bargain stores: Sales at the retailer's factory stores, where Coach sells the previous season's bags or irregular leather goods from its factories at a discount, were up 33.4%, while its retail store sales were up 20.8%. Wall Street investors too were a bit worried. Despite the stellar earnings numbers, Coach's shares fell 7¢ to \$43.91.

Retail investors remember how Calvin Klein and Tommy Hilfiger lost the shine on their images when they flooded the discount market. Image is clearly an issue among upscale brands. Tiffany's ([TIF](#)), for instance, decided to increase the price on its hugely popular silver jewelry items, fearing that huge sales will tarnish its upscale image. Coach, of course, is known for quality craftsmanship and lately high design. In recent years, it has also introduced purses that are more affordable and priced under \$200, and even under \$100 in its factory outlets. These steps have clearly attracted a new set of middle-income buyers who previously didn't shop at Coach, and some fear the brand might lose its cachet if its reach extends too far. "There's always the danger of overextending yourself," says Passikoff.

Of course, so far Coach has proved many naysayers wrong and been on an unprecedented growth path. Patricia Pao, founder of New York retail consultancy The Pao Principle, believes that Coach will not falter in its expansion plans because the company's moves are market research-driven, well planned, and well executed. "They really know the game of building a brand, creating customer experience, and introducing goods that keep customers coming into the store on a daily or weekly basis," Pao says.

[Gogoi](#) is a contributing writer for *BusinessWeek.com*.

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