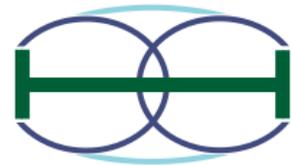


Strategic Report for Tiffany & Company



Harkness Consulting
Innovation through Collaboration

**Jenn Wilcox
Scott Damassa
Zeeshan Hyder**

April 14, 2007

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Executive Summary

Throughout its history, Tiffany & Co has been a luxury jewelry brand associated with romance, quality, and style. Originally gaining fame as a silversmith and later for its association with engagement rings and diamonds, Tiffany & Co now reaches a wide market through its sale of high-end jewelry, watches and glassware. Tiffany's has grown steadily alongside the American economy and expanded across the United States and into South America, Europe, Asia and Australia. The firm offers a wide array of price points in its pieces, from sterling silver items under \$100 to quarter of a million dollar signature pieces covered in diamonds and other gems. Tiffany & Co sells jewelry under its own name as well as featuring collections designed by famous artists such as Elsa Peretti, Frank Gerry, and Paloma Picasso. The firm has traditionally found success in the diamond engagement ring industry, statement jewelry, and sterling silver items. The industry is characterized as notoriously "tight-lipped," where consumers are buying both a piece of jewelry along with its associated status and brand recognition. The supplier power on DeBeers and others is critical to shaping the industry's dynamics and future.

In an industry characterized by private labels and almost secretive dealings, Tiffany & Co took a dramatic step in 1987 when it decided to go public. Trading under the ticker TIF, the company has a 52-week range between 32.84 and 57.34, with a market capitalization of \$5.84 billion. Some jewelry experts and consumers speculate that since its public offering Tiffany has "lost some of its luster,"¹ but the firm's explosive growth from 1999-present indicate that the business model is based in solid financials.

Recently, several factors have affected the performance of both Tiffany's and the luxury goods industry. Typically, spending in general and on luxury goods in particular depends greatly on consumer confidence in the economy as a whole. With the recent economic slowdown of late 2007, Tiffany & Co as well as the luxury jewelry industry has experienced dramatic decline, captured in a particularly poor holiday season. Facing further anticipated economic softening, the firm has decided to open an alternative store

model in the Los Angeles area that focuses exclusively on its lower-end sterling silver jewelry whose average price point is \$200. Tiffany & Co is also focusing on growth opportunities in non-Japanese Asian markets as well as opening its first store in the Middle East.

In this report, Harkness Consulting focuses its attention on two main strategic issues. This first issue is the risk to Tiffany & Co if the initiatives above cause its brand to be perceived as diminished in quality and commercialized relative to its high-end competitors. With the success of lower price point sterling silver pieces, Tiffany's has arguably already lost some of the status it enjoyed in the 1980s and before, made famous in the movie *Breakfast at Tiffany's*. However, these items account for roughly a third of sales², indicating this is a popular sector of the business model. By making the Tiffany & Co brand accessible to individuals willing to spend \$100-\$200 on a piece of jewelry, the firm has dramatically expanded its market share. However, the strategy of opening stores that focus exclusively on these lower price point items may dilute the brand beyond repair, hurting the other third of sales on high-end, multi-gem pieces. Harkness Consulting recommends that Tiffany & Co approach this new store model carefully, and consider naming this lower-end store something different to ensure customers aren't confused about the merchandise being sold. Additionally, the firm should further create an air of exclusivity without raising prices by creating "limited edition" pieces in its collections.

The second strategic issue Harkness will focus on is how Tiffany & Co can continue to grow both in established markets and emerging markets. Harkness recommends that rather than oversaturate US markets by opening excessive numbers of new stores, Tiffany should focus on expanding both its lower and higher end lines through the introduction of a new designers with established name recognition. However, Tiffany & Co must be careful to pick a high-end designer who will enhance the exclusive nature of the Tiffany & Co brand. Within the established Japanese market, the firm should further explore the concept of "men's only" stores to explore new growth opportunities.

Within non-Japanese international markets, Tiffany & Co faces exciting expansion opportunities. While sales in these markets are already strong and growing, Tiffany must ensure the brand is associated with the utmost quality, customer service, and sophistication by focusing its marketing and store formats on high-end gemstones and engagement jewelry.

Company Background

Tiffany & Co. has long been renowned for its luxury goods and has sought to market itself as an icon of high-end trend. Tiffany's designs, manufactures, and sells jewelry, watches, and crystal glassware. It also sells other timepieces, sterling silverware, china, stationery, writing instruments, fragrances, leather goods, scarves, and ties. Jewelry, however, accounts for over two-thirds of Tiffany's sales volume. Many of these products are sold under the Tiffany name, at Tiffany stores throughout the world as well as through direct-mail and corporate merchandising.

In 1837 Charles Lewis Tiffany and John F. Young opened Tiffany & Young, with \$1,000 in backing from Tiffany's father. In 1841 Tiffany and Young took on another partner, J. L. Ellis, and the store became Tiffany, Young & Ellis. By 1851, the firm established the Tiffany Silver Heritage collection, beginning what would be a long history of high-quality silver pieces. In 1853, Charles Tiffany renamed the company Tiffany & Co.

In the 1860s, Tiffany & Co became intimately tied with the American political landscape. In 1861, Tiffany was commissioned to design a pitcher in honor of Abraham Lincoln's inauguration. To celebrate the occasion, the President bought his wife, Mary Todd Lincoln, a Tiffany seed-pearl jewelry suite. Throughout the Civil War, Tiffany & Co played an active role by supplying the Union Army with surgical instruments, flags, and swords. Once the war was over, Tiffany created gemstone-encrusted swords for Admiral Farragut and Generals Grant and Sherman

Tiffany's prestige reached a new level when it won the gold medal for jewelry and grand prize for silverware at the Paris Exposition in 1878. Soon it was serving as a jeweler, goldsmith, and silversmith to most of the crowned heads of Europe. In that same year,

Charles Tiffany purchased what is now known as the Tiffany Diamond, a 128.54 yellow diamond that has been on display at the 5th Avenue store ever since.ⁱ Tiffany's association with high-quality diamonds was strengthened in 1886 when Tiffany introduced the "Tiffany Setting" engagement ring setting—a 6-prong solitary engagement ring setting—now considered the standard in the industry. This reputation was solidified when Charles Tiffany was called the "kind of diamonds" by the American press after acquiring some of the French Crown jewels.ⁱⁱ Alongside its established reputation in Europe, Tiffany clearly established itself in America. America's growing upper-class, however, began to dominate Tiffany's clientele base as the company saw its first spurt of growth in the mid 1910's as sales volume rose from \$7 million in 1914 to \$17.7 million in 1919. By 1926, Tiffany platinum became the official standard for platinum in the United States.

However, the 1929 stock crash prompted the rich to cut back on luxury goods. Tiffany's sales fell 45 percent to \$8.4 million in 1930, dropped another 37 percent to \$5.4 million in 1931, and yet another 45 percent to a rock bottom \$2.9 million in 1932, when the federal government imposed an additional ten percent on the excise tax for jewelry.

Soon after, Walter Hoving became the new chief executive officer of Tiffany's and immediately brought change by conducting the first bargain sale in the firm's history to clear out merchandise he considered gaudy or vulgar. He dropped diamond rings for men for that reason and discontinued leather goods, antiques, silver plate, brass, and pewter as not worthy of Tiffany's attention. To broaden the base of its clientele, the store added high-quality but lower-priced goods. The balance sheet reflected Tiffany's turnaround. Annual sales reached \$21.9 million in fiscal year 1966. Net profits rose every year, from \$173,612 in 1955 to \$1.7 million in 1966. Business continued to grow in the 1970s.

Part of the firm's successful turnaround is attributed to the publicity associated with the Truman Capote novel (1950) and subsequent Audrey Hepburn movie (1961) *Breakfast at Tiffany's*. For publicity photos, Hepburn wore the Jean Schlumberger's Ribbons Necklace with the Tiffany Diamond clipped on in the center. This symbolized not only

the elegance that had been associated with Tiffany & Co, but also helped to promote the new collection designed by Jean Schlumberger that premiered in 1956.ⁱⁱⁱ

Tiffany & Co bolstered their national image in the 1960s by working closely with national figures and organization. In 1967, Tiffany was commissioned to design the first Super Bowl trophy, subsequently renamed the Vince Lombardi Super Bowl Trophy. A year later, First Lady Mrs. Lyndon Baines Johnson commissioned Tiffany to design a White House china set, featuring American flowers.

Tiffany & Co expanded their relationship with designers by entering into a partnership with Elsa Peretti in 1974. Elsa Peretti sculptural shaped designs were immediately popular, gaining her the recognition of Accessories Designer of the Year in 1996.^{iv} In 1980, Tiffany & Co introduced the collection of yet another famous designer, Paloma Picasso.

^vIn 1978 Tiffany & Co. was sold to Avon Products Inc., the world's leading manufacturer and distributor of cosmetics and costume jewelry, for about \$104 million in stock. Tiffany's sales had reached \$60.2 million and net profits about \$4 million in the previous fiscal year. Avon spent \$53 million to open Tiffany stores, expand its direct mail orders, introduce Tiffany credit cards, and streamline its back-office operations. But its ratio of operating profits to revenue fell from 17.6 percent to 6.5 percent between 1979 and 1983, mainly because it tried to compete with department stores in selling low-margin watches, china, and glassware. It was noted that the Fifth Avenue store had so many inexpensive items that it began looking like Macy's during a white sale, and that customers had complained about declining quality and service. An investor group led by William R. Chaney agreed to buy Tiffany's from Avon in 1984 for \$135.5 million in cash after the company had earned only \$984,000 in 1983 on sales of \$124.2 million.

Under its new management Tiffany & Co. shifted direction again, focusing on regaining its image as tasteful and high-end. In 1986 it earned \$6.7 million on net sales of \$182.5 million and during 1987 it earned \$16.8 million on net sales of \$230.5 million. Tiffany's went public again in 1987, raising about \$103.5 million by selling 4.5 million shares of common stock. Along with going public, Tiffany's also introduced a wide range of new

products including fragrances, wool and silk scarves, a line of handbags, evening purses, wallets, and briefcases. A London store was reintroduced in 1986 and stores in Munich and Zurich opened in 1987 and 1988, respectively.

Tiffany's had also expanded its direct-marketing effort as catalog mailings reached 15 million in 1994. These publications were seen as a powerful sales and image tools for the stores as well as a source of profit in themselves. The Far East also played an important role in Tiffany's resurgence. Mitsukoshi Ltd., the "Bloomingdale's of Japan," accounted for \$26.5 million of Tiffany's \$290 million in sales in 1988 as they began to stock Tiffany's items in their department stores. Tiffany's opened two stores in Hong Kong during 1988 and 1989, a third in Taiwan in 1990, and a fourth in Singapore in 1991.

1992 proved to be another down year for Tiffany's for two reasons. Sales to Mitsukoshi fell 35 percent and hurt by a recession, Japanese consumers had cut back spending, catching the retailer with more inventory than it needed. These reasons along with the 1990-1991 recession in the U.S. prompted Tiffany's to refocus on mass merchandizing once again. A new information campaign stressed that the average Tiffany's purchase was under \$200 and that diamond engagement rings started at only \$850.

This marketing campaign proved to be successful as Tiffany's net sales rose to \$682.8 million in 1994, with a growing percentage from international retailers. By mid-1995 Tiffany's was leasing 18 retail stores in the United States. Internationally, the firm was established in both London and Tokyo. In 1995, the Louvre Museum honored Tiffany designer Jean Schlumberger after his death, only the third time the museum has honored a jewelry designer.^{vi} Tiffany's experienced continued growth through 2000 and as of 2007, the company operated 64 Tiffany & Co stores in the U.S and 103 Tiffany & Co international stores including locations in East Asia, Europe, and the Middle East.

In addition to this growth, Tiffany & Co continued to work in the public eye. In 2004, NASCAR commissioned a hand-crafted Tiffany trophy. The firm also secured Frank Gehry, renowned architect of the Guggenheim and Walt Disney Concert Hall, to design a collection of jewelry in 2006.

Currently, however, with winter holiday sales in 2007 below estimates, Tiffany's management is seeking to weigh the options of redirecting their marketing efforts towards lower-end and more diversified merchandise. Furthermore, as evidenced with previous recessions, management is worried another slowing of the economy could provide another blow to the already declining sales of Tiffany's.

Competitive Analysis

Tiffany & Co operates in the Service Sector and is characterized by industry in a variety of ways depending on the course. Reuters classifies TIF as Specialty Retail (which includes firms such as Bed Bath & Beyond), while Yahoo! Finance lists TIF in its Jewelry Stores industry. Yet beyond classification, because so many of Tiffany's key competitors are privately held, firms like Nordstrom's and Saks Fifth Avenue are frequently used on financial sites as comparisons.

Because Tiffany & Co operates in so many facets of the luxury jewelry industry, all of Tiffany's core consumers must be considered when determining competitors. Tiffany services three key consumer groups: engagement ring shoppers, customers looking for luxury items, and jewelry shoppers. For the purposes of this report, we will examine other luxury jewelers, such as Mikimoto, Cartier, David Yurman, Bulgari and Harry Winston. While discount jewelers such as Whitehall and Zales exist and command impressive markets, Harkness does not consider them key competitors to Tiffany & Co because of the difference in core consumer demographics

Internal Rivalry

The luxury jewelry market is characterized by several competitors with a select few firms having the brand recognition to command large portions of the market. High-end competitors such as DeBeers, Harry Winston, Bulgari, Mikimoto, and David Yurman all compete for international market share alongside countless other smaller national and international players. Additionally, local and regional boutiques that feature equally stunning pieces typically play well in local markets because of the personalized experience buyers seek when purchasing high-end jewelry. While many of these high-

end competitors specialize within the luxury jewelry industry – DeBeers with diamonds, Mikimoto with pearls, Cartier with watches—each competitor produces a variety of pieces and styles with various stones and metals and competes with Tiffany & Co to varying degrees within its three core consumer groups.

Within the jewelry shopper consumer group, Tiffany & Co faces additional competitors. Jewelers such as James Avery in Texas specialize in silver and gold jewelry in the \$65-\$300 price range. While many of these regional players exist, Tiffany’s high-end reputation allows the firm to maintain a national and international presence in the jewelry shopper demographic.

Within the luxury item and engagement ring atmosphere, Tiffany & Co is a strong competitor. The high prices of Tiffany’s pieces come from four main sources.

1. *Quality of diamonds and cuts.* Tiffany & Co is known primarily as a diamond jeweler. Because much of its brand recognition is associated with its high quality engagement rings, Tiffany & Co seeks to continually provide its customers with the highest quality diamonds and cuts.
2. *Craftsmanship.* Beyond its diamonds, Tiffany & Co seeks to maintain the highest level of craftsmanship in all its pieces.
3. *Designers.* Unlike many of its competitors, Tiffany & Co has exclusive contracts with artists to design collections. Elsa Peretti, Paloma Picasso and Frank Ghery have all designed collections with a wide range of price points. These collections give Tiffany & Co high-quality diversity within its pieces, but also increase the price point of its items.
4. *Brand Recognition.* Tiffany & Co’s greatest asset is its brand recognition. Tiffany’s dominance as the standard for engagement rings has propelled the brand to all elements of jewelry, with Tiffany & Co being associated with luxury, quality customer service, and romance. Additionally, Tiffany & Co has gained further brand recognition with its designer collections. For example, the open heart Elsa Peretti necklace has gained Tiffany & Co newfound brand recognition as a high-quality, yet affordable, silver jeweler.

In terms of cost and pricing, Tiffany & Co experiences similar market patterns to its variety of competitors. Luxury jewelers, especially ones as large as Tiffany & Co, use similar supply chains. However, Tiffany & Co's use of independent, brand-name designers increases their cost of certain collections. The industry as a whole tends to keep prices relatively stable, but may be forced to adjust to changing market conditions in the diamond industry in the future. Tiffany & Co reports that prices of all diamonds are increasing because of scarcity, and that prices of diamonds larger than one carat are increasing at a faster rate.^{vii}

Within the luxury jewelry industry, competition in watches is particularly fierce. Especially for men, watches are the ultimate status symbol, and the brand of the watch is paramount. Customers tend to "graduate" to more expensive brands as their wealth allows, or collect various brands for different occasions.^{viii} Currently, Tiffany & Co does not have a substantial presence in the highly profitable watch industry, but has entered into a partnership with Swiss-based Swatch to increase recognition and market share. Executive Vice President of Merchandising, Jon M. King, reports that Tiffany & Co is extremely excited about the Swatch alliance as an opportunity to navigate the watch market and establish a long-term presence in the market.^{ix} The effects of this partnership remain to be seen.

Following the pattern of luxury good providers, Tiffany & Co's sales follow an exaggerated pattern of the market as a whole. In times of economic boom, excess disposable income is reflected in increased sales. In times of economic bust, luxury jewelers tend to suffer more than the market as a whole. Tiffany & Co, following the luxury retail trend, experiences largely seasonal sales with the holiday season being the most profitable.

These patterns, however, are not as pronounced in the engagement ring and lower-end silver jewelry markets. While silver jewelry also experiences largely seasonal trends,

neither of these categories are affected as dramatically by economic downturn as high-end luxury goods.

Downstream from the high-end jewelers like Tiffany and Co are the second rate jewelers, such as Whitehall, Zales, and even Wal-Mart. Many of these firms purchase second-rate diamonds that the high-end jewelers deem unsuitable for their needs. Tiffany & Co reports that the sale of these second-rate diamonds does not provide any material income for the company.

Entry

The luxury jewelry industry is a mature market where buyers look for established and reputable brands. Tiffany & Co reports that the single greatest asset it owns is its brand recognition. The iconic image of the little blue box or well-known DeBeers slogan “a diamond is forever” are types of brand recognition that take decades to establish.

Additionally, firms need to have a significant amount of startup capital to enter into this industry. Luxury jewelers typically turn over their inventory once a year, meaning they must invest up front in all metals and gems without initially being able to create a profit.

New entrants may also have difficulty procuring raw materials. Large diamond producers will only sell in bulk to buyers, leaving smaller jewelers the leftover gems the large companies deem unsuitable for their needs. These secondary diamonds are frequently of inferior quality, meaning new entrants either need to have a connection with diamond distributors or find a way to compete with lower-quality gems. Alternatively, new entrants may find a specialty beyond diamonds, such as David Yurman has done with high-quality metals with occasional gem accents.

However, once a firm has established itself with suppliers and in at least one market, expansion into new geographic regions has proven successful for many firms. Tiffany’s in particular has experienced strong international growth in Latin America, Europe, and Asia with plans to enter the Middle East via Dubai in 2008. Chairman and CEO Michael

J. Kowalski reports, “It’s clear that our international sales are steadily becoming more geographically diversified.”^x

Substitutes and Complements

The luxury jewelry market has few substitutes, as it is the “symbol of romance.” The timeless marketing strategy of all jewelers—and diamond jewelers in particular—is that luxury jewelry is a timeless, tangible symbol of love.

Yet within the luxury jewelry industry, substitutes exist between different types of products. While Tiffany & Co sells all types of jewelry—from diamond necklaces to pearls to watches—certain retailers certainly specialize in different styles or designs. Tiffany & Co is seen as the dominate player in engagement ring and silver, while Mikimoto is the leader in luxury pearls and Rolex is the leader in luxury watches.

Additionally, while brand recognition is paramount for luxury jewelers, brand loyalty is limited as many retailers can produce relatively similar high-end products. For example, there is little to distinguish a traditional diamond tennis bracelet from Harry Winston, Tiffany & Co, or DeBeers. To combat this, Tiffany & Co has asked its designers to create a fresh approach to many traditional pieces, giving them a distinct Tiffany & Co look. Customers may retain a certain degree of brand loyalty if they develop a relationship with a clerk at a store, but other than that there are no switching costs associated with movement among luxury jewelers.

Within the lower-end silver styles Tiffany & Co produces, substitution is less of a threat. The company characterizes this category as non-gemstone, sterling silver jewelry whose average price point is \$200. The open-heart Elsa Peretti necklace has become the symbol of this portion of the market, which accounted for 30% of total 2007 sales. Many of these pieces are sold to younger women, for whom the necklace is meant as a status symbol of being associated with the Tiffany & Co brand.

Supplier Power

Diamonds

The diamond industry is largely controlled by DeBeers, though their supplier power is slowly eroding as governments demand more autonomy over their diamonds and the company is forced to address compelling social responsibility demands from diamond-rich countries. The European Commission entered into an agreement with DeBeers to gradual reductions of purchases from Alrosa, a Russian-owned diamond company. In 2006, DeBeers entered into 50/50 joint ventures with the governments of both Botswana and Namibia. In South Africa, DeBeers sold 26% of its equity to Ponahalo Holdings in 2006 as part of a commitment to Black Economic Empowerment.

To address this decline in control over the industry, DeBeers is working to expand its mines into Canada and open new mines in Africa.

Moreover, DeBeers is working to address its international image as being exploitive of local governments and people. The concessions in Africa to joint-partnership and sale embody an effort to reverse this image. Additionally, DeBeers guarantees that 100% of its diamonds are conflict-free, and claims to be active in reducing the sale of conflict diamonds.

In addition to DeBeers, Tiffany & Co purchases diamonds from 6 other suppliers. With diamond mines being controlled progressively more by local companies and governments, worldwide diamond supply is becoming increasingly contingent on the political stability and situations in diamond-producing countries. Tiffany & Co reports that if distribution from one or more of its seven suppliers were to be cut off, it would dramatically and adversely affect its sales. However, the risk of such a disruption is low, and will continue to decrease as the diamond industry becomes controlled by a growing number of players.

Because the diamond industry is controlled by a limited number of players and availability of diamonds is decreasing, Tiffany & Co reports that it is has had increased

difficulty acquiring diamonds for its engagement business. As a result, some stores are not able to maintain a comprehensive selection of diamonds of various cuts, clarity grades, sizes and colors.

Other gems and precious metals

Tiffany & Co purchase finished jewelry from over 90 manufactures. While many of these relationships are well-established, Tiffany & Co does not enter into long-term contracts with suppliers. Within the other gem and precious metal category, it does not appear as though suppliers exert a dramatic amount of supplier power.

Buyer Power

Tiffany & Co exerts little to no buyer power in the luxury goods industry. However, because it purchases both rough and finished diamonds in bulk from its suppliers, certain diamonds do not meet Tiffany & Co's standards and must be sold to third parties. Tiffany & Co resells these diamonds at market prices, and is unable to make any significant profit from these sales.

SWOT Analysis

Strengths

- Strong brand recognition
 - Brand associated with romance
 - Blue Box recognition
 - Standard engagement ring setting named a "Tiffany setting"
 - Association with quality, sophistication and tradition
- Ability to benefit from DeBeers diamond advertisements
- Established relationship with suppliers
- Increased market with more accessible price points
- Diversified product lines (price points range from \$30-\$250,000)
- Established relationship with well-known designers (Elsa Peretti, Frank Gerry)
- Strong real estate locations
- Entry threat by other firms very low

- Better access to leverage because of public status
- In markets all across the country

Weaknesses

- Highly volatile industry that relies on excess disposable income
- Highly seasonal sales
- Does not have enough diamonds to have full selection of engagement diamonds in each of its stores
- Has lost perceived quality and mystique since going public
- Growing concern about the diamond industry and association with conflict diamonds
- Dual identity: both high end and lower end price points
- Dual brand perception: too nice for average consumer, but too commercial for high end consumer
- Low switching costs for consumers
- Limited brand loyalty

Opportunities

- High growth opportunities in Asian and European markets
- Erosion of the DeBeers cartel will lead to more competitively priced diamonds
- Expansion of men's jewelry line
- Partnership with Swatch to increase distribution of luxury watches in Europe
- Building consumer loyalty by offering lower price point items that appeal to younger consumers

Threats

- Over-saturation of the US market
- Repeal of Bush tax cuts hurts disposable income of target consumer
- Diamond supply chain disruption because of local political conflicts
 - Possible destabilization of African diamond markets because of decreased DeBeers control

- Synthetic diamonds increasing in popularity
- Possible perception of declining brand quality
- Unpredictable exchange rate fluctuations
- Changing consumer preferences
- Counterfeit goods, especially lower price point sterling silver items
- Numerous competitors at varying price points

Financial Analysis

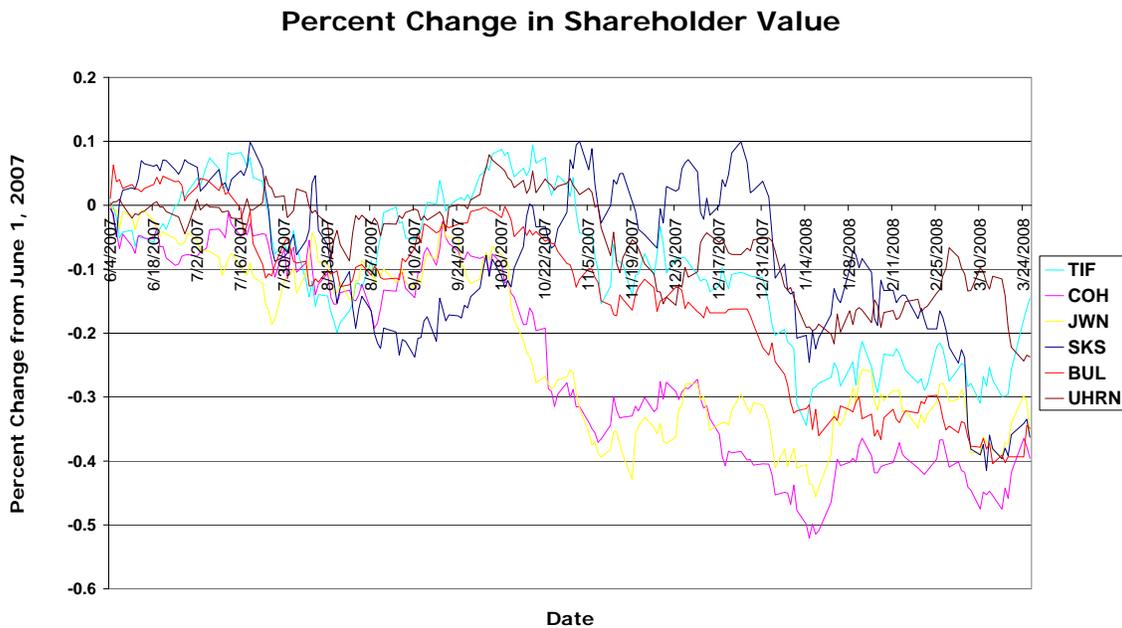
Since the 2001 recession, Tiffany & Co has displayed financial patterns that mirror exaggerated market trends. The recent financial difficulties associated with the credit crisis have had an adverse affect on Tiffany shares since Q4 2007, and is expected to linger well into 2008. Like many retail and specialty retail companies, Tiffany & Co's overall financial security relies heavily on its fourth quarter performance during the holiday season. A confluence of factors in Q4 2007 resulted in earnings below expectations, a near 30% decrease in shareholder value from Q3 2007 to Q2 2008.

However, the financial outlook for Tiffany & Co is not altogether gloomy. While US Sales are expected to continue to slow, Tiffany & Co is aggressively working to grow internationally beyond their stronghold in Japan. In 2007, Tiffany & Co added a net of 17 new stores in the US and abroad and plans to further expand its footprint in 2008, led by a near 15% increase in international markets. The firm anticipates 10% growth in international markets and low single digit growth in the United States in 2008.^{xi} Relying largely on international expansion, the firm has announced an optimistic growth in earnings per share for 2008.

One of the primary reasons Tiffany & Co has faced recent financial difficult is the overall decrease in the economy and consumer spending. Many analysts speculate that once the market began to turn in summer 2007, consumers became more focused on preserving their wealth than on purchasing luxury goods. While many of Tiffany's

direct competitors are privately held, domestic luxury brands such as Coach, Nordstrom's, and Saks Fifth Avenue have experienced declines in shareholder value similar to Tiffany & Co since summer 2007. Internationally, luxury jewelers Bulgari (Italy) and Swatch (Switzerland) underwent equal declines in the same time period. The relative performances of these firms are displayed in Figure 1.

Figure 1



Examining the financial statements of Tiffany & Co over the past 5 years indicates that the problems faced since Summer 2007 are not representative of longer nagging issues. The net cash conversion cycle has decreased by 10.5% from 2006, indicating that the firm's cash is less tied up in financing activities and can be used to invest. Part of this decrease is the result of inventory turnover increasing from 1.03 to 1.07 from 2006 to 2007. Within the luxury jewelry market, this ratio is typically around 1.0.

The balance sheet indicates relatively consistent allocations of assets, liabilities and shareholders equity over the past 6 years, indicating that Tiffany's model has remained constant as shown in Figures 2 and 3.

Figure 2

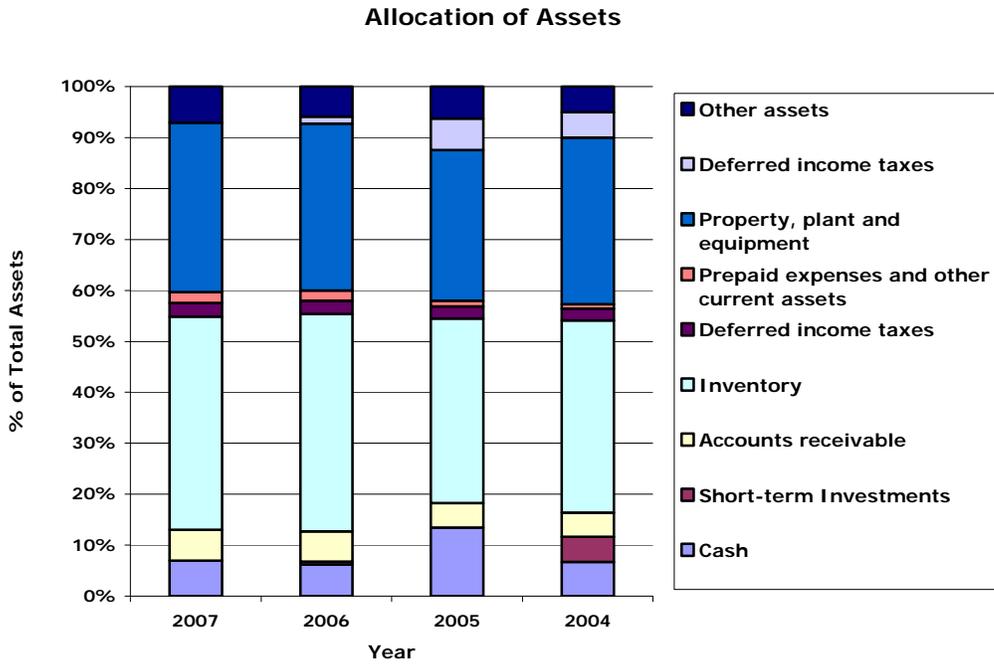
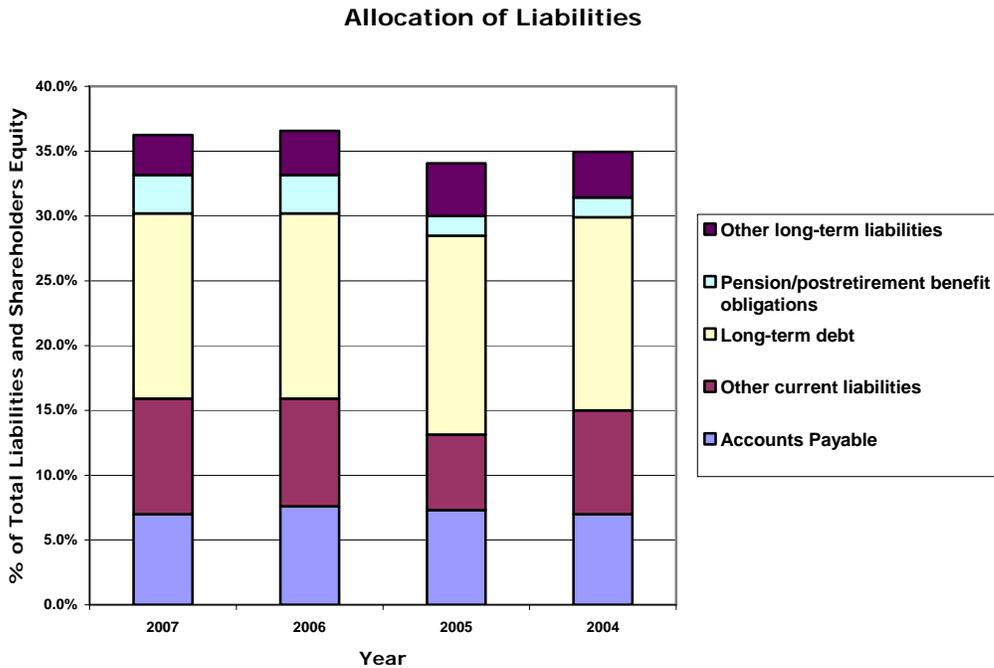


Figure 3



The income statements of the past 5 years indicate that this consistent model has translated to consistent growth. From 2003-2007, sales revenue increased robustly every year, with a 3-year annual compounded growth rate between 9.4%-13.7%. Gross profit also steadily increased during this period. Despite the lackluster holiday season in 2007, Tiffany still experienced an 11% increase in sales revenue from 2006. Many analysts predict that the market downturn will continue to be felt in 2008 as consumers continue to curtail their spending on luxury goods.

Looking forward, most analysts believe that Tiffany & Co's optimistic 2008 outlook is a bit too rosy. Management predicts that the US market will face pressure throughout the first half of 2008 and improve in the second half. However, JP Morgan, along with many other analyst reports, is less optimistic because of uncertainty of macro indicators across the economy.^{xii} Tiffany remains vulnerable to a declining market at home that may not remedy as quickly as Tiffany's management is predicting. Merrill Lynch reports that this market downturn in particular will be rough on Tiffany since many of its core high end customers will be "negatively affected by Wall Street layoffs and poor investment performance and will not benefit from the fiscal stimulus rebate package."^{xiii}

Additionally, Tiffany & Co is vulnerable to an increasingly weak dollar. While foreign tourists accounted for 10% of the New York Flagship store's sales in Q4 2008, a weak dollar hurt the firm's total revenue since 41% of net sales came from international channels in 2007.^{xiv} Tiffany must carefully hedge currency fluctuations into its expected earnings.

Strategic Issues and Recommendations

Harkness Group does not recommend any major overhaul of the Tiffany & Co model. Rather, the firm's century-old strategy must be slightly modified and updated to keep up with dynamic international economies and consumer preferences.

There are two main strategic issues facing Tiffany & Co. The first is the threat the Tiffany & Co brand faces as being perceived as low-quality and commercial relative to

its high-end competitors. Since its inception, Tiffany & Co has focused a comparatively large amount of attention on sterling silver. The success of sterling silver pieces, characterized by the Elsa Peretti open heart necklace (inset) has increased access to the Tiffany & Co brand to a much larger market. However, increased access and affordability has necessarily resulted in the Tiffany & Co brand losing some of the status associated with exclusivity and luxury. Much of Tiffany's reputation is based on selling jewelry beyond the reach of the average American, made famous in the movie *Breakfast at Tiffany's*.



These lower price point silver items—and the Elsa Peretti designs in particular—are incredibly popular. These pieces accounted for roughly a third of sales in 2007.^{xv} The Elsa Peretti open heart necklace has become synonymous with the brand for many consumers, and its relatively accessible price point has allowed Tiffany & Co to dramatically expand its market share.

In addition to its established popularity, the current economic and political landscape in America indicate these items may be more popular in the coming years as sales in general and of high-end items in particular may continue to slow. Harkness Consulting anticipates that the traditional Tiffany & Co target consumer will face continued economic pressure from the credit crisis and possible recession and will not receive any aide from the government stimulus package because his or her income will be above a given threshold. Moreover, if a democrat is elected as president in November 2008, Harkness Consulting believes the Bush tax cuts will be repealed, further decreasing discretionary spending available to the target Tiffany's consumer. Given this outlook, high-end, multi-gem piece sales will decline from its current share of roughly a third of total sales.^{xvi}

Given the popularity of the sterling silver pieces and the future of the economy, Tiffany & Co has already announced it will experiment in 2008 by opening a smaller store in the Los Angeles area that will focus on sterling silver collections, featuring jewelry in the \$100-\$15,000 price range.^{xvii} These stores should be less expensive to operate and should

increase inventory turnover.^{xviii} Additionally, this format will expand the number of markets Tiffany & Co can enter profitably. Currently, Tiffany & Co operates 70 stores in the United States, and this smaller store format increased US store potential to 170.^{xix}

However, the strategy of opening stores that focus exclusively on lower price point items may dilute the brand beyond repair, hurting long-term sales. Tiffany & Co reports that the smaller store format will enhance the intimacy of the buying experience for customers purchasing items for themselves.^{xx} However, Tiffany must carefully weigh the increased short-term sales to the inevitable long-term brand dilution. One key issue Tiffany must consider is whether this lower-end store will still be called “Tiffany & Co.” Currently, Tiffany already operates stores of varying sizes, with smaller stores offering fewer pieces than the larger stores. However, focusing a store exclusively on lower-end merchandise runs the risk of confusing customers who expect to see a wide range of Tiffany & Co items. If the firm chooses to expand this model beyond the Los Angeles area, this problem will become more pronounced. Harkness Consulting recommends that Tiffany & Co approach this new store model carefully. If the firm wishes to sell only lower-end items, it should consider naming the store something like “Tiffany Silver” or even “Tiffany’s” instead of the traditional “Tiffany & Co” to ensure customers are clear on the difference between the stores.

Within the sterling silver pieces, Tiffany & Co could establish exclusivity without increasing prices by creating “limited edition” pieces. Each collection could design 1-3 pieces per year within the lower price range that is sold in limited quantity and then retired. Branded “Tiffany limited,” these pieces could debut the day after Thanksgiving, playing on the already seasonal sales of luxury goods. Advertisements could focus primarily on the exclusive nature of these pieces rather than their relatively affordable prices.

The second strategic issue Harkness will focus on is how Tiffany & Co can continue to grow. The first area Tiffany needs to focus on is its established markets. Tiffany’s is currently experiencing dramatic growth in Europe and non-Japanese Asian markets, but struggles in US and Japanese markets where it has been established since 1837 and 1972

respectively. Harkness recommends that rather than oversaturate US and Japanese markets by opening excessive numbers of new stores, Tiffany & Co should focus on expanding both its lower and higher end lines through the introduction of a new designer with established name recognition. This strategy fits into Tiffany & Co's reported key growth strategy of "maintaining an active product development program."^{xxi} Such a line would allow the firm to reach existing customers with fresh and original pieces, increasing customer loyalty. It would also attract new customers through innovative designs and name recognition. Possible designers might include an established fashion designer, artist, or interior decorator. Currently, each designer collection includes pieces that vary dramatically in price, indicating that introducing a new designer would potentially increase sales across the spectrum of price points.

Introducing a new designer might also act as a way to foster an atmosphere of exclusivity in the experimental lower-end store. While this designer could create pieces across price points for the firm as a whole, he or she could also create some designs exclusive to the lower-end store. This would create a positive distinction between the small stores and the traditional model.

The firm should also further explore the concept of "men's only" stores in Japan. In general, men are more brand-focused than their female counterparts, and Tiffany & Co should play its strong brand to its advantage in this market.^{xxii} Japanese men in particular are extremely brand-focused. These stores will help portray Tiffany & Co not just as an engagement ring store, but as a luxury destination for men, potentially opening up a new market within Japan.

Tiffany & Co expects continued international expansion, particularly in Asia (excluding Japan), Europe and Latin America. 2007 and Q4 in particular experienced "robust sales" in international regions excluding Japan.^{xxiii} This quarter resulted in GAAP SSS of 33% in Asia Pacific and 16% in Europe. This international exposure should allow "Tiffany to trade at a premium" as the brand expands.^{xxiv} This expansion is planned with the opening of 20 new stores internationally, building on the strong growth patterns established in 2007.

As Tiffany & Co continues to expand internationally, it must be careful not to oversaturate markets and to ensure that its brand is associated with the highest levels of quality and prestige. To achieve this, Harkness Consulting recommends that international stores focus its marketing campaigns on luxury items and ensure that its stores allocate considerable space to engagement and gemstone jewelry. In 2007, these sales categories accounted for 30% and 24% of international sales respectively.

Overall, Harkness Consulting recommends that Tiffany & Co keep preservation of its brand front and center in its strategic considerations both domestically and internationally.

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