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LPP - Reserved

Growth Strategies of a Fashion Retailer in Central and Eastern Europe

In early March 2008, Marek Piechocki,¹ President and Chief Executive Officer of LPP S.A. and his management team, had to make their final decision about whether or not to buy Artman S.A.

Until now, LPP S.A., with headquarters in Gdansk, Poland, had been operating three different chains of fast fashion clothing retail stores: Reserved, Cropp Town, and Esotiq.

All in all, by the end of 2007, they had a grand total of 345 retail stores of all brands, located in nine different countries² in Central and Eastern Europe. By the end of the year, these 345 stores occupied a retail space of about 149,000 m².³ The company had firm plans to open a further 89 new stores in 2008, so by the end of 2008, LPP was planning to have a grand total of 434 retail stores. This would include the new stores to be opened in Romania and Bulgaria. The total retail space would reach 187,000 m².

All three of their present retail chains were growing at a fairly fast rate, much above the overall rate of growth of the Polish retail sector. But the question still was: would this “organic” growth be enough? Or should LPP consider acquiring one or more additional competitive chains of fast fashion retail stores? Or should they attempt to grow by way of launching another completely new fashion retail chain?

¹ To be pronounced “Pijotski” (The “j” sounding like the h in “house” in English).

² Namely: Poland, Russia, Ukraine, Lithuania, Estonia, Latvia, Czech Republic, Slovakia and Hungary.

³ The majority of new openings usually took place in the second half of the year.

This case was prepared by Professor Lluís G. Renart as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation. September 2008.

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For several months now, Piechocki and his management team had been negotiating the possible acquisition of Artman S.A., owner of the fashion retail chain House, described in Exhibit 1.

The final buying price would be around 400 million Polish New Zlotys or PLN,⁴ which was about 50% higher than the going market price of Artman's shares in the Warsaw stock exchange.

Should they go ahead with this purchase? Was the price too high? Were they being too optimistic regarding the estimated potential increase of sales and profitability of the House chain, once it was to be in the hands of LPP?

The Origins of a Startup Venture

Marek Piechocki was born in Kartuzy, a small town located some 60 kilometers south of Gdansk. In 1961, his family moved to the larger town of Koscierzyna, about 30 kilometers away from Kartuzy. His mother had a grocery shop. During the period 1980-1987, he studied Civil Engineering in Gdansk and also in Brunswick, near Hanover, in Germany, where he not only studied, but also worked part-time and saved some money. He graduated with a Master of Science degree in Civil Engineering, with a specialization in steel construction.

When things started to change in 1989, after the unexpected fall of the Berlin wall, Jerzy Lubianiec, a Polish friend he had known while in Germany, came to him with the idea of flying to Singapore, buying merchandise with cash, and personally taking it back into Poland. Initially, they traded in electronic goods, such as computers.

Then, in 1990 they started importing finished garments, mostly sweaters, from Turkey. The demand was huge. They imported the merchandise as personal luggage, as if it were "for the family", even though they were acting as importers-wholesalers, and subsequently sold it to other retailers located anywhere in Poland. Initially they were operating under the business name "Mistral".⁵

The year 1992 was a turning point for several reasons. They became aware of the fact that they were losing competitive advantage due to imitators. Therefore, they introduced some major changes in their business model: first, they started importing from China; then, they also started creating their own designs, prepared by Piechocki himself and the garments were to be sold under their own brand names.

For instance, they started to use the brands "Ross" for jogging suits, "Henderson" for shirts and men's underwear and "Promo Stars" for caps, tee shirts, blouses, polo shirts, and windbreakers. They also started importing garments embroidered with customer companies' brands who bought them as promotional goods for major international brands

⁴ The going currency rate of exchange was about 3.3 Polish New Zlotys (PLN) to 1 Euro.

⁵ They did not change the name to LPP until November 1995. LPP meant "Lubianiec, Piechocki and Partners", even though this full name was never actually used. Over the years, different people would come up with different creative, funny interpretations of these initials, like "Lots of Profit and Potential", or "Lots of Permanent Problems"!

like Coca-Cola, British Petroleum, many brands from the Procter & Gamble portfolio (such as Ariel, Pampers) and also major Polish companies like TPSA (Polish Telecom). At the same time they became distributors of garments of the US brand “Fruit of the Loom”.

In 1993 their total turnover was around PLN 10 million, and they had maybe a total of about 15 employees (full time equivalent).

In 1995, the first hypermarket opened in Poland by a relatively small German chain called HIT.⁶ Within a couple of years, many more opened in Poland such as Géant, Carrefour, or Real (belonging to the German Metro Group). Following the French model, these large-format mass retail outlets sold both food and non-food items, including “bazaar” (hard goods) and textiles, as well as toys, appliances, personal care items and toiletries, etc. They were capable of generating a huge volume of business, and therefore, offered the opportunity of very fast growth for their suppliers.

The following year, 1996, saw its share of new developments. For one thing, LPP started using the brand “Reserved” on “casual wear” garments sold directly to small shops. This was a reaction to the perception of the high prices at which a competing brand, “Cottonfield”⁷ was selling.

As a matter of fact, in 1996, LPP was importing garments and selling them under different brand names, using different channels of distribution:

- Directly to small shops.
- Indirectly to wholesalers, who, in turn, sold the garments to retailers.
- Directly to Hypermarkets such as Auchan, Metro, Makro Cash & Carry, Real or Carrefour.
- And promotional garments sold either directly or indirectly large corporate customers, usually embroidered with their particular logos.

Also in 1996, they started re-exporting their garments to other East European countries through exclusive importer-distributors.

By about 1998, the managers of LPP concluded that “selling to mass retailers and to wholesalers was not going to last forever”. Therefore, they took a key strategic decision: to start opening their own retail stores.

The first own retail store was opened in 1999 in Szczecin. It was only 80 m², but the managers of LPP considered it “too big”! This first retail store required almost a year to reach break-even. The first few retail stores were opened as “LPP Fashion Point”, and their basic mission was to sell the garments that might have been returned by wholesalers or hypermarkets directly to end consumers. But shortly afterwards the name was changed to “Reserved”. One of the reasons for such change was because

⁶ HIT was later on bought in Poland by TESCO from the UK.

⁷ In 2008, this brand belongs to IC Companies (<http://www.iccompanies.com/cds/showpage.asp?nodeid=19716>).