UNITED COLORS OF BENETTON.

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Analysis

Outline

Abstract

The Benetton Group, controlled by the Benetton family via Edizione Holding, is one of the world's leading apparel designers, manufacturers and marketers. The main UCB brand is one of the largest high profile brands. After the boom it experienced in the late 80s and early 90s, Benetton went through a period of sluggish sales and it is now in urgent need of being reinvigorated. In this report we analyze the factors that highlighted the brand in the past and the causes that fueled its decline, after which we examine the possibilities of revitalizing the brand, considering in this approach the economic environment and the marketing mix.

01 Introduction

1.1. Overview

Benetton is the Europe's largest clothing manufacturer and the world's largest consumer of wool in the garment sector. Today, the group is present in 120 countries, having 9 factories in different parts of the world and over 5,000 sales outlets generating a total turnover of 2.0 billion Euros, net of retail sales. It is a company with a strong Italian character whose style, design expertise and passion are clearly seen in the United Colors of Benetton and the more fashion-oriented Sisley brands, in The Hip Site, the brand for teenagers, and in sportswear brands Playlife and Killer Loop.

The development of Benetton's commercial organization has been supported by a major programme of investment in megastores, some of which are run directly by the group, per its plan to control distribution, others by long-standing partners. These stores are characterized by their generous dimensions, their prestigious locations in historic and commercial centres and by the high quality of customer services they offer.

As in the case of the commercial network, a constant commitment to innovation, a crucial factor for development, has always characterized the group's business organization.

Despite its global spread, Benetton has maintained close relations to its local origins, especially through cultural activities of the *Fondazione Benetton Studi e Ricerche* and through programmes about sport. The group's ability to engage with society is also evident in *Fabrica*, Benetton's communication research centre, that backs young artists from all over the world. Fabrica's challenge is both an innovative and international one. It is a way of marrying culture and industry, using communications which no longer rely on the usual forms of advertising, but transmit 'industrial culture' and the company's 'intelligence' through other means: design, music, cinema, photography, publishing, internet.

1.2. Background

Benetton was established in 1965 as a partnership by the Benetton family (Luciano, Giuliana, Gilberto and Carlo) in Ponzano Veneto, Italy. It was reorganized as a limited liability company in 1978. The Company adopted the name Benetton Group S.p.A. in a corporate reorganization effective in 1985. Prior to June 1986, the company was wholly owned by the Benetton family. In June 1986, shareholders affiliated with the family sold shares representing approximately 11% of the ordinary shares to the public in Europe. The Benettons initiated the public offering in order to establish a liquid public market for the company's ordinary shares and to facilitate its access to the international capital markets, with the listing on the Frankfurt Stock Exchange in Oct 1988. Today the Group is also listed on the stock exchanges of Milan and New York. (For a description of Edizione Holding, the Benetton family's holding company, please consult Appendixes A and B.)

02 Marketing Environment

2.1 Key Challenges

Doyle and Bridgewater have identified 3 dimensions in today's marketing environment:

- **Collapse of boundaries** as a result of globalization. The boundaries set barriers to new entrants and limit competition in individual markets, but now these boundaries are crumbling and 'buyers and competitors no longer recognize geographic country limits.'
- **Rising customer expectations** as a consequence of 'increasing competition and global over-supply.' Today consumers want greater value in terms of lower prices and higher quality as well as solutions tailored to their individual needs.
- **Speed of change.** The changes in customer expectations, technologies and management policies have led to an acceleration in the speed of change across all industries. 'Unless a new car, toothpaste, computer or machine tool is perceived to be "new" and the "latest thing," consumers loose interest. Continual, incremental innovation has become essential to preserve market share and profit margins.'

These are challenges Benetton has to cope with, and the extent of its success will be analyzed further.

2.2. Environmental Factors

- **Competitive Forces**. The major competitors of the Benetton Group are *Inditex* (*Zara*), a Spanish-based designer and retailer with 6 fashion chains and over 1,200 stores world-wide; *The Gap*, an international $ 11 billion (US) company and *H&M*, a Swedish company boasting about $ 6 billion (CDN) in sales.

Today, the UCB brand is present in 120 countries while the likes of Zara and H&M are in not more than 30 countries. However, this wide presence is difficult to control and might increase inefficiencies. The company plans to do a clear analysis per region and to decide where to invest or divest, if the return is not sufficient to justify the brand's presence.

Table 2.1 – Benetton is the most global of all high street fashion brands

Brand	**Global presence** (countries)
Benetton	120
Inditex	45
H&M	15
Mango	70
Gap	6
Esprit	>40

Source: JP Morgan

H&M, Zara and Mango entering the Italian market pose a threat to domestic market share. Attracted by the high levels of market fragmentation of the Italian clothing sector (where more than 60% of the market is still in the hands of small independent retailers), the competitors recently opened flagship stores in the country. This will impede on Benetton's ability to further grow its domestic market share, particularly as both H&M and Zara are enjoying a more dynamic momentum. Benetton's casual business has roughly 40% of its store base located in Italy and generates around 35% of its sales in this market.

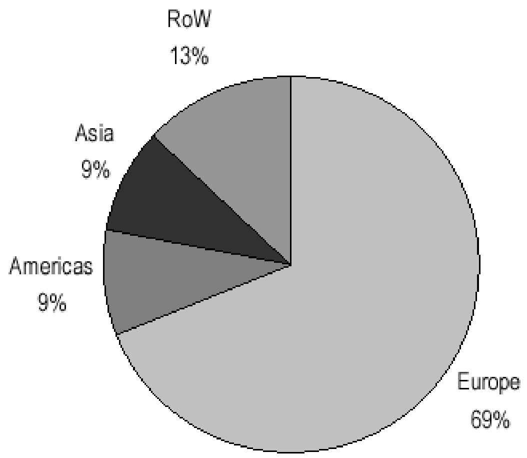
More important, however, is Benetton's inability to keep up with a changing industry. Whereas the likes of Zara can successfully translate catwalk trends to the shop floor in less than one month, Benetton has lost its 'cool' factor and has became out of fashion. For example, Gap does four ranges in a year while Benetton is still delivering two main ranges. Ironically, the other competitors adopted a style that was initiated by Benetton in the 80s and not the other way around. Silvana Cassano, the new Benetton Group's CEO, said that one of his priorities is to make each single employee ready to react quickly and to challenge new competitors, at least in the regions where Benetton has strong market share.

Another problem arises from the fact that Benetton are mainly manufacturers, not retailers, thence the need to move to a more professional retail management. 'The issue is that 93% of Benetton's sales come from franchise operations. Zara and H&M, in contrast, own their shops, which makes it easier to install unified systems that track global sales electronically,' says Armano Branchini, a Milan-based consultant.

- **Economic Forces.** The economic outlook is tough, in particular in Europe. Over half of Benetton's sales are generated here, with Italy being the most important market followed by Germany. Clearly, a further deterioration of the economic sentiment will put some pressure on the group. Nevertheless, in the past the brand has showed good resilience to the economic environment, as people tend to trade down when situation becomes tough and Benetton therefore should be less impacted than other high-end brands. However, conducting a price survey, Morgan Stanley Dean concluded that Benetton's product prices are relatively high compared to the other brands. This makes Benetton's position precarious against the backdrop of

potentially weaker consumer discretionary spending and intensifying competition, especially that now buyers view the UCB brand as being somewhat dated and not overwhelmingly innovative.
The group manufactures 90% of its products in Europe and thus it is not, in principle, a beneficiary of the US dollar weakness in the same way as is the case for H&M or other retailers that manufacture their products in the Far East.

Figure 2.1 – Sales exposure by region, FY 2003



Source: JP Morgan, Benetton data.

Almost 70% of Benetton’s revenues are generated in Euros, and JP Morgan estimates that close to 90% of its costs are in euros. The company’s exposure to the US dollar in terms of sales is roughly 13%. Japan accounts for roughly 5% of sales, while the rest of the world accounts for 13%. During Q1 2003, the negative impact of currencies on Benetton’s sales was roughly 3.8%, as a result of the strength of the Euro versus the USD, the Yen and sterling. JP Morgan assumes a negative impact in sales for FY 2003 of roughly 2-3%.

- **Political, Legal and Regulatory Forces.** The Benetton Group has always maintained a high level of transparency, conforming to the most advanced regulations of corporate conduct. For example, during 2002, following the implementation of the ‘Regulation for Markets Organised and Managed by Borsa Italiana SpA,’ the Board of Directors officially adopted the ‘Code of Conduct for Internal Dealing,’ which envisages tighter timing and involves wider categories of subjects and securities than does the Regulation of Borsa Italiana SpA. Since Benetton Group SpA shares are also listed on the Frankfurt Stock Exchange, the Code of Conduct also implements the obligations of notification and disclosure mentioned in the Wertpapierhandelsgesetz – WpHG law (Securities Trading Act), introduced by the 4°Finanzmarktförderungs (Forth Financial Markets Promovation Act).

In spite of its transparency and impeccable conduct, the group has been surrounded by controversy especially as a result of its 'Institutional Campaigns.' These advertisements aim at publicising the entire company as a whole rather than one range of clothing. Through this marketing technique they aim not only to keep public attention for their corporate name, but also to associate Benetton with trying to raise awareness about certain issues, such as racial equity. But after a series of billboard posters showing images of a nun and a priest kissing, body parts labelled 'HIV positive' (for which the company was fined) or a military cemetery filled with crosses, complaints started to be made against Benetton. As a result, some of the campaigns were banned by the Advertising Councils in several countries, including Germany. The 2000 campaign showing death-row inmates stirred so much controversy that Oliviero Toscani, Benetton's Creative Director for the last 15 years, was forced to leave the company to be replaced by James Mollison.
Despite the ad controversy, Benetton managed to maintain an admirable corporate image during Italian government investigations conducted in 1993 that involved more than 5,000 of the country's political and business elite.

- Technological Forces. A constant commitment to technological innovation was always a characteristic of Benetton's business organisation, from communication to IT, from research into new materials to integrated logistics.
Special attention is given to innovation in production, where all systems and equipment are totally renewed every five years. The Benetton production system, coordinated by a high-tech facility at Castrette (Treviso, Italy), operates with a structure of computerised machines that are programmed to operate all knitting phases. One of Benetton's innovations is the computerised knitting procedure capable of producing a complete, seamless sweater in half an hour thanks to a software program conceived by Benetton specialists.
From the very beginning, Benetton decided to maintain direct control of the logistics phase and has invested heavily in automating logistics processes in order to achieve total integration within the production cycle, from customer orders to packing and delivery. With a workforce of only 24, compared to the 400 people normally required, the Automated Distribution System at Castrette automatically stocks, invoices, selects and ships the finished product directly to the group's 5,000 retail outlets.
At the end of 2002, the manufacturer has selected SAP to implement a software system specifically designed for the clothing and footwear industry. SAP Apparel and Footwear is an enterprise management system that supports financial processes, order fulfilment, supply chain management and logistics. After Benetton installed the system at its production facilities, logistics centres and retail outlets worldwide, the IT solution enabled it to improve its planning, sourcing, distribution and replenishment processes. Benetton is among other 50 companies, including footwear suppliers Adidas-Salomon and Nike, to have chosen the SAP system.

In the spring of 2003, Philips announced that Benetton had placed an order of 15 million ID chips (Smart Labels). The Radio Frequency Identification (RFID) chips were going to be used in an effort to improve Benetton's supply-chain management system. The chips, which are incorporated into the clothes during manufacturing and are imperceptible to the consumer, can indicate where a garment is in the inventory process or within the company's 5,000 stores. Following this announcement, Benetton issued a statement saying that it is currently analysing the technology to evaluate its technical characteristics and that no microchips were ever incorporated in its garments.

- Social and Cultural Forces. The unconventional irreverent image associated with Benetton as a result of their institutional campaigns means they have to target markets that are open to controversial issues. It has been suggested that the group should change their communications strategy if they intent to use this form of advertising in stricter or more religious markets because their campaigns are very likely to offend in these regions. This can happen because cultural barriers are far more inflexible, meaning that the advertisements could easily be banned or Benetton boycotted if the messages are thought to be controversial.

Benetton has made headlines in the past with campaigns addressing topics such as AIDS and racism. In the 90s it prompted protests from the Roman Catholic Church for a picture showing a nun and a priest kissing.

After the Death Row campaign in 2000, major retailer Sears, Roebuck & Co. severed ties with the Italian clothier as a result of customer complaints. Sears' spokesman declared that 'the advertising campaign was inconsistent with what Sears has come to stand for and is inconsistent with the customer base we serve.' Benetton officials said the ads were meant to raise awareness about the death penalty, but victims' rights groups declared the ads glorified convicted killers and were insensitive to victims' families and friends.

Ever since 1984, when the institutional campaigns started, they have gathered awards and acclaim in all the countries the company's present; by the same token they have aroused strong reactions – at times ferocious, at times simply curious, confirming that they are a focal point of discussion and of confrontation of ideas.

2.3. Ethics and Social Responsibility

- Ethical Behaviour. During FY 2002, the Board of Directors coming into line with the most advanced standards of corporate governance, officially adopted the 'Code of Ethics.' This is designed to instil correctness, equity, integrity, loyalty and professional rigour into operations, conduct and ways of working into both relationships inside the group and those with persons and entities outside the company. The Code places a central focus on compliance with the laws and regulations of the countries where the group is active, as well as on compliance with company procedures.

Already in 2001 the Board of Directors had set up the Internal Audit Committees, formed by non-executive directors and independent from company ownership and management. The committee has the following tasks, i.e. to

- monitor compliance with, and periodic revision of, corporate governance rules;
- verify together with the head of the administrative function and the internal auditor the adequacy of accounting principles;
- evaluate the results presented in the independent auditor's report; a.s.o.

As a result, the organisation and information systems were found to be able to assure, also as regards subsidiaries, monitoring of the administrative and accounting system and of the central and decentralised organisational structure. Work continued on mapping the risks concerning the group companies' businesses, as did operational and budget control of individual businesses and auditing of internal auditing system by outside auditors.

- Community Relations. The social responsibility refers to an organisation's obligation to maximise its positive impact and minimise its negative impact on society. The first channel Benetton used to develop its community relations were its advertisements, through which they strive to raise the public awareness of universal problems among world's citizens.

Following the past series of campaigns that focused on war, racism, AIDS or death penalty, and after the departure of the creative director Toscani, Benetton launched a communication campaign for 2003 which focused on food, investing more than 15 million Euros in over 30 countries. The global *Food for Life* campaign has been developed in association with the World Food Programme and aims to re-establish hunger as the world's most fundamental problem, since it was largely overlooked by both media and public.

The group's ability to interact with society is also evident in Fabrica, Benetton's communication research centre. Guided by an international team, which also supervises its strategic, cultural and communication policies, Fabrica supports the creative development of young artists/researchers from all over the world. In its role as an applied creative laboratory the centre experiments new forms of communication, ranging from cinema to graphics, from industrial design to music, from publishing (Colors Magazine and other publications) to new media and photography. Several of the projects created here in cooperation with prestigious associations (including FAO, UNV, WFP) obtained important acknowledgements at an international level.

The Benetton Group has long been involved in a series of cultural and sporting activities. Some of these, such as the Leleque Museum under the patronage of Benetton in Patagonia, where more than 15,000 archaeological finds narrate the history and culture of this mythical land, and the Pivano Library, primarily dedicated to American literature, located at the Benetton offices in Milan, reflect the Group's international outlook.

Others, such as the Benetton Foundation, which focuses on issues relating to the preservation and promotion of local heritage, reflect the strong links which the Group has traditionally maintained with its territorial roots.

These territorial links are also an important component of Benetton's approach to sport. From its involvement in rugby, volleyball and basketball, to its historic victories in Formula One, the Group promotes not only the quest for competitive excellence, but also an important social element focusing on participation, meeting and physical well being. The success of this approach can be measured in the thousands of young people who are introduced to sport every year at the Benetton city of sport: La Ghirada.

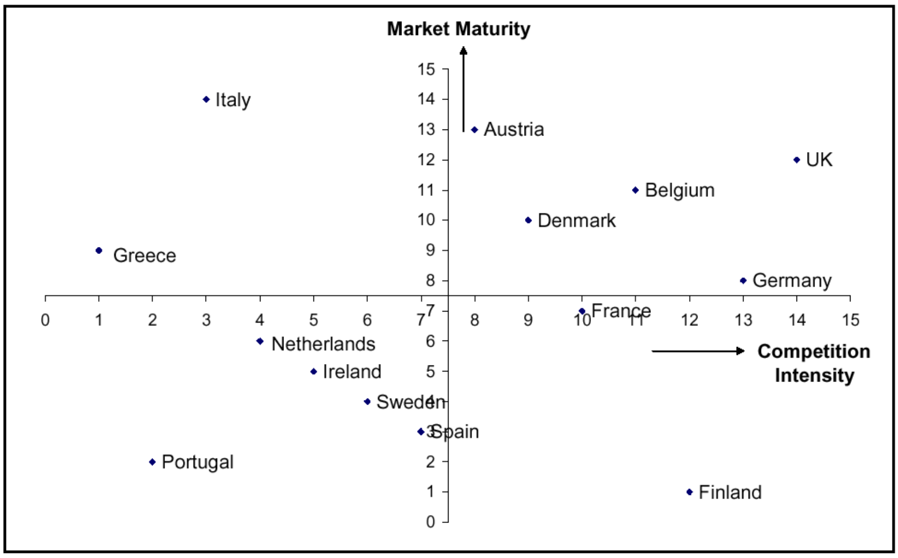
2.4. International Marketing

Benetton's founder, Luciano Benetton, started his business into entrepreneurial style by exploiting what he considered a nichè market at the time. He noticed that there was little colour in the majority of clothing people wore and therefore decided that there was a clear market for more colourful products of a substantial quality. His keen observations proved to be correct and the company grew into the global clothing manufacturer Benetton now is.

Competing in various markets is never an easy task. The company became successful by making 'industrial fashion,' stylish apparel made and sold through flexible, cost-effective production and retailing systems. The first store was opened in 1968 in Belluno in the Italian Alps, and then the next year the company opened its first shop in Paris. Luciano knew that introducing Italian fashion to the sophisticated Paris market would be a challenge, but if Benetton was successful there, Benetton could make it anywhere. With 1,000 stores in Italy alone, the group realised that the home market was saturated and ensued a major export campaign. Benetton focused on the rest of Europe along with US and Japanese markets. However in 1988, after years of profitable growth, sales deadlocked in Italy. In the US, which accounted for roughly 15% of total sales, income fell 20%. The slowdown in Italy was due to a weak dollar, rising apparel prices, saturated markets, the raising cost of Italian labour and shifting tastes, especially in the US. Moreover, in the late 1980s, American store owners charged in dozens of legal disputes because Benetton encouraged too many outlets to be built too close together and failed to supply them adequately, forcing the company to pull back in the rich US market. From around 500 stores, only 150 remained. Luciano declared that the company misread what Americans wanted, wrongly assuming that because the sweaters were selling so well in Paris, they would sell as well in New York.

Benetton penetrated to global market using primarily the franchise system. Its distribution strategy revolves around a large network of independent franchisees and resellers who invest capital in their own stores. These in turn buy merchandise from Benetton and sell directly to the retail customers (which makes Benetton primary a wholesaler). The group does not impose very strict rules on the independent distributors regarding the presentation of merchandise, completeness of range and general store ambience. As such, the company's strategy could be termed 'franchise-like' compared with, for example, McDonald's. From one angle, this gives a great level of flexibility to the group, but it also gives less control over product positioning and the way merchandise is presented to consumers. This raises the risk of inconsistencies and variations in consumer perceptions due to detriment of the overall brand. Second, relying on third-party distribution weakens business intelligence and customer feedback and generally creates a less responsive business model compared with, for example, Zara and H&M. However this strategy allowed Benetton to have a high global presence at a low cost and with risks that, overall, are compensated by the benefits.

Figure 2.2 - European Clothing Markets: Maturity and Competition



Source: Retail Intelligence 2002, Verdict 2002, OECD 2001, Morgan Stanley Research

In its effort to reach more markets the group launched in 2000 their online e-shopping site in conjunction with Accenture, entitled theex.it. The state-of-the-art distribution and logistics systems allowed Benetton to be in a position whereby it is extremely easy for them to deliver a custom order within a very short space of time. The site currently allows customers to purchase any product from the many lines of clothing available and have it delivered free to any destination in UK, Germany and Italy. Although e-commerce sites have been struggling in the last years, theex.it has Benetton to support it through any difficult periods that may ensue. The group done its best to ensure that the site is as useful as possible by making it available in different languages and by allowing delivery in as many areas as is feasible.

03

Buyer & Market Evaluation

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The fashion thrives on building images and attitudes. Nothing sales clothing better than provocative icon, emotional symbol, or brand image that is embedded into the customer's minds. People identify with the advertising or ideology and therefore use that particular brand to express themselves. Benetton understood this since the beginning, and it used attitudinal and unconventional advertising, mixing political and social issues with their ad messages in their campaigns. In addition, something consistent in their advertising is their cosmo approach, using for example multiracial and unusual-looking models to deliver their message. Benetton supports and illustrates the unconventionality in their brand personality as their campaigns veer away from the pleasing aesthetics commonly associated with clothing/fashion brands. This has created an association with consumers in that they equate unconventionality and shock with the brand Benetton. Apart from their institutional campaigns, the group launched product advertising campaigns in which it actually showed the products as they were, colourful, practical and full of energy.

Together these two communication channels targeted the brand towards a specific buyer profile: stylish but casual, practical, modern and dynamic. Only the independent-minded and creative people could appreciate their message and identify with it. In terms of prices, the brand focuses the upper-middle market. The consumers adopt a limited problem solving approach when buying the products, and their level of involvement may be both *enduring* (in the case of a loyal consumer that appreciates the brand for its attributes as he finds that it responds to his desires) and *situational* (an on-the-spot decision to buy triggered by a particular circumstance or environment in which the buyer finds himself).

However their products have no major differentiation with the other fashion brands and finally caused problems, making the sales to stagnate. Benetton did no seem to take the opportunity its reputation brought to match cutting-edge campaigns with cutting-edge designs, instead it focused more on product advertising, somewhat ignoring the shocking institutional campaigns that made the name famous. This change in their advertising direction to a more toned-down approach has fallen into the category of mass appeal and hence made them loose the edge in the eyes of the consumers. This has resulted in confusion as there seems to be a change in brand personality and image. Many customers today are interested in being seen as 'individuals.' By buying into the Benetton brand they had achieved this, but now that the campaigns have been toned-down so dramatically the target consumers are searching for a new, more shocking brand that can accommodate their needs.

Utkarsh Saxena at Ogilvy&Mather proposes the following scenarios to account for the momentum lost by the Benetton brand:

1) Lack of consistency in the integrated marketing communications, where the mass-media advertising never matched the rest of the consumer touch-points, hence creating a mismatch in brand personality-image;

2) Inability of constantly reinventing the 'shock' appeal so as to stay relevant and exciting to the consumer;
3) Loosing the 'shock' appeal and inability in being seen as unique/distinct and clutter-breaking;
4) Lastly, a possible mistake on stretching the 'shock' appeal too far instead of restricting it to a short-term strategy where it was very successful.

Today, Benetton's apparel business includes five brands: *UCB*, the group's flagship brand; *Sisley*, the trendiest brand; *The Hip Site*, the newest group brand and, finally, two sport-inspired brands: *Killer Loop* and *Playlife.* According to Merrill Lynch estimates, UCB is by far the greatest contributor to group sales and earnings, accounting for 63% of Benetton Group's 2003 E sales excluding the sport equipment contribution. UCB is also the largest brand in terms of target customers. It is meant for children (0-12 years old), teenagers and adults (30-40 years old).

Table 3.1 - Benetton Group 2003 Sales by Brand

Brand	2003E (EURm)	As % of 2003 Cons. Sales	As % of 2003 sales Excl. Sport Equipment
UCB	1095	60%	63%
Sisley	469	26%	27%
Playlife	31	2%	2%
Killer Loop	21	1%	1%
Total Sales	1615	89%	92%

Source: Merrill Lynch estimates

In reality, this wide consumer ranges are a problem for the strength of the brand because this weakens the brand's advertising message and price positioning. Benetton risks not knowing its clients and thereby loosing brand momentum and sales. Furthermore, management underlined that UCB, while very strong with babies and children, is becoming weak with teenagers. The gap is important because they can loose long term customers as they grow up. The group has already planned and budgeted significant marketing analysis in order to identify who UCB's clients are today, while internally they try to identify who the customers should be and then bring the two pictures together.

Table 3.2 - Brand competitive and SWOT analysis

Brand	Price Positioning	Major Competitors	Long-Term Growth Drivers	SWOT Analysis: Strength	Weakness	Opportunities	Threat
UCB	Mid	Gap, Zara, Stefanel	Regaining momentum and market share	One of the most powerful brands in the world	Lost momentum versus competition	Given the lack of management in past, we feel that few simple actions can already take good results	Management poor track record
Sisley	Mid-high	Max&Co.; Versus, D&G, Just Cavalli	Expanding Abroad	Strong design and good quality at a more affordable price than designers	Almost unknown abroad	Regional Expansion	Significant investments necessary
The Hip site	Mid	Miss Sixtie, Fornarina, H&M	Distribution and Regional Expansion	Designed for an attractive and important consumer force	Start up brand	Good expansion opportunities in Italy and then abroad	Volatility of teenagers' purchases
Playlife	Mid	Nike; Reebok; Sergio Tacchini; Napapijhri	Distribution and Regional Expansion	Good retail network and spend investments already made	Unclear positioning	Expected superior growth for life style brands	Tough Competition
Killerloop	Mid	Reef, Quicksilver	Distribution and Regional Expansion	Strong international brand	Lost heritage	Expected superior growth for life style brands	Tough Competition

Source: Merrill Lynch

Being both a wholesaler and a retailer, Benetton addresses the reseller markets as well as the consumer markets, but its distribution strategy revolves mainly around a network of independent franchisees. They buy merchandise and sell directly to the retail consumer. In an effort to improve the relation with the final buyer, Benetton started an ambitious programme of investments in real-estate, planning to open more retail outlets directly controlled by the group. The problem is that by distributing primarily through independent retailers, the company is less able to gather business intelligence and to respond quickly to market changes, affect the brand positioning and the brand as a whole.

In the past, Benetton has always directed its marketing efforts towards what the group's management recognized as its clients: the stores network, but not towards the final retail customer. This was a wrong marketing approach that could not maximize the group marketing and advertising effort. In other words, Benetton only took into consideration the sell-in, without consistently monitoring the sell-out, which is what drives the sell-in and not vice-versa. But now the management seems fully committed to completely change this approach and will be using more sophisticated IT systems (in addition to the previously installed SAP system) to get continuous feedback from its customers.

04

Product Decisions

4.1. Product Identity

Back in the 80's when Benetton launched its new product line, based then only on clothing and accessories, under the brand name United Colors of Benetton nobody knew how much this will grow.

Today United Colors of Benetton is one of the best known world brands, with daring campaigns and new, innovative and high quality products this brand stayed in the top for more than twenty years. Anything done under this brand proved to be successful from the start.

The mix of products made under the brand name United Colors of Benetton include the consumer products as brightly colored clothing lines, accessories, shoes, baby clothing lines, each collection with is own personality adapted for a larger consumer scale as possible. The organizational products include licenses and franchising.

The UCB products designed for young people of all ages, colors, nationalities, with the desire to have more color in their life.

As a 'clothing services company' Benetton through United Colors of Benetton stated that no one was excluded from their targeted consumers, united meaning just that.

This multiracial theme was repeated in succeeding years with the slogan 'United Colors of Benetton', a slogan so successful that it became the trademark of the company. United Colors of Benetton is rich with meaning; it suggests, among other things, the United States, united races, a united Europe and a united world. This is consistent with the philosophy of the company, which is truly global and generates the majority of its revenues and profits outside Italy.

The creative department of UCB is made entirely of young graduates from art schools all over the world, 200 young designers create more and more new colorful and diversified products, maintaining like this UCB as one of the worlds most successful brands. But still after the departure of Oliviero Toscani in 2000 the brand maintained the same success as ever.

4.2. Technology

What makes UCB products different from all others is their high quality, starting from the raw material that at the beginning was mostly virgin wool (in the 80's the main products of UCB were knitwear, today only 35% of sales) and today also pure cotton, then the high quality of the production process, finishing with a high quality product.

With constant commitment to innovation, very important for development, Benetton has the newest technology in domain, starting with computerized high-tech cutting and packing plant for jeans and jackets at Ponzano, developed software for machine-knitted seamless sweaters that require no hand finishing ready in half an hour, dyeing vats operational 24 hours a day, all this ensuring the high quality of the products with which UCB accustomed its buyers.

The main UCB customer products are clothing with no boundaries, no rules full of bright colors inspired by the young spirit of the customers. From the casual to the formal to the sporty all these tastes are combined in each of the UCB collections. UCB does not create outfits or styles the customer can create its own personalized outfit, look by combining different materials in the collection. Still in all collections knitwear plays an important role not only for sweaters, jackets, and cardigans, but also for dresses, coats or even trousers.

Each adult collection is differentiated for all type of customers, for weekend people, campus people, street people and evening people, for each type of personality.

Each clothing collection is accompanied by an accessories collection to complete each look with a great range of accessories. From hats, flat caps, berets and gloves in various patterns and materials as wool, tweed, and needle cord. Accessories include also scarves plain or stripy with flower patterns or not from silk or wool for autumn or winter. Trendy bags, belts from natural leather, or tweed can't be missing from any outfit.

4.3. Nichè Expansion

With the developing of the market UCB extended also its view over its younger customers and developed lines for children, from diapers and strollers to clothing for school children, sport collections, winter and a punk collection to encourage children creativity. The choice can be done from different looks from a multi-ethnic look with its faux Mongolia fur sheepskins and jacquard knits, to camouflage or army stile each to represent the child personality.

The new babies' products include skin care products, swimsuits, toys, and maternity underwear for every mom and her baby.

'More than just a diaper… It's an Italian designer garment,' reads a Ledysan sales presentation. The high-fashion brand's Year 2000 Collection features diapers in vivid red, orange, blue, green and yellow designs. Ledysan expects the diapers to be priced at parity or even slightly below Huggies and Pampers in the U.S. Though the brand focuses on fashion, Ledysan claims the diapers are about as absorbent as Pampers.

United Colors of Benetton is broadening its horizons expending the brand into new areas of merchandise. Benetton's latest creations brings its signature style and colors to various products that range from Home Collection, kitchen accessories, terrycloth line, to new toiletries line, perfumes and exclusive watches.

The newest products launched on the market are under the UCB licenses and are household products like rugs in bright eye- catching colors, in abstract shapes, big patterns or plain colors, like all other products are of high quality from cotton fiber weave for double-faced version, or hand-knotted in soft wool.

This year the UCB home collection included also candles of all shapes sizes and colors. The kitchen accessories are from padded pot-holder, tea towel to apron and oven glove. All made from pure cotton.

One new collection is the b.clean line, with colorful toiletries not just for washing, with delicate fragrance waters, creams that nourish the skin, exfoliating lotions. B.clean expressed in four states like fresh, soft, relaxed, energy for each mood. A new inclusion in the product lines is the new ready-to-use colored paints and special effect finishes for walls with a different and original look for each personality. From a great variety of textures that include Metallic, Rag & Roll, Jeans and Cord, this gives a new and personalized touch to each home.

The life of cycle of the consumer products is of maxim two seasons due to the fact that all clothes change with the season and along most of the accessories lines, this makes very important the creation and development of new and variants products to maintain the position in the market.

The most buyers of UCB products are young but today UCB is trying to attract new generations of 15-25 years old to its bright colors, without losing their predecessors, this proved to be a difficult task for other companies.
As other companies Benetton is keeping a contact with its customers beginning with the public department and the communications one, and now also with the new Colors publication through which Benetton was able to use current issues such as AIDS, and racial discrimination, war to promote its items.
Developing new and diversified products ensured the survival of UCB a very long time and in April despite the recession in its West European market, still for UCB was increase in the sales with 9.5% to profits of 2.75 trillion lire, surprising seeing that Benetton spends 4% of sales revenue on marketing.
In 2000 the company started to invest in mega stores (today 169) characterized by larger dimensions and a high level of customer services.
Aggregate sales climbed at a 25% to 30% annual clip in the last two years as the number of Benetton shops doubled. But the breakneck expansion masked an unpleasant trend: For many established stores, sales began falling off after the first few years.
But in the last years the demand started to decrease and the sales in the sporting products decreased at an alarming rate, all this determined the executives of the company to take measures: appointment of a new management team, apparel business repositioning and re-launch of sport apparel brands, selective network growth, product quality enrichment and technology improvements.
The company farms out 80% of its production to small factories from all around Italy.
More than 90% of Benetton's merchandise is still made in Italy. Benetton now plans to begin producing in the Far East, probably within the next year.
The expansion has already started with new shops in Egypt, India and South America and soon 300 new shops in China.
Some Benetton customers may not like what they see when next they look at the label showing the origin of Benetton garments. To slow the damaging rise in prices, the company is moving to lessen its dependence on Italian suppliers.
This expected move to the Asian continent may not happen, Luciano Benetton argues that the key to competing with clothing producers based in Asia is 'modern industrial production' meaning computers.
Also Benetton has started a campaign of cutting prices up to 40% to increase market share in Europe: volume is up 25% in some markets, the chief executive of Benetton, Aldo Palmeri said.
Selling in more than 7000 shops in over 110 countries Benetton will continue to rule in European market for a long time even after the departure in 2000 of its creative director Oliviero Toscani, considering that since 2000, in spite of the West European market recession Benetton sales revenues increased.
Everyone expects now to see how the new management will develop in the future more and more the success of UCB.

Table 2 : Benetton 1H revenues by activity (€m)

Total revenues by activity (€m)	1H02	1H03	% change
Casual	800	783	-2.2%
Sport apparel	26	19	-26.5%
Sport equipment (discontinued)	110	101	-8.6%
Other	65	66	2.1%
Total	1002	969	-3.2%

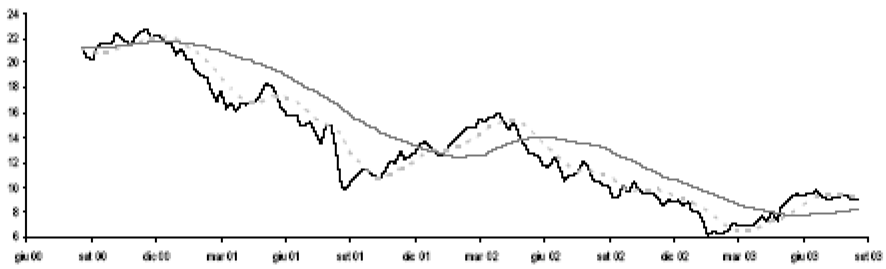
Source: ABN AMRO Estimates

EUR	12/02	12/03e	12/04e	12/05e
Sales (m)	1.991,8	1.803,5	1.757,0	1.792,1
EBITDA (m)	375,5	338,0	367,5	391,6
EBITA (m)	266,3	246,6	268,5	286,1
EBITA margin	13,4%	13,7%	15,3%	16,0%
EBIT (m)	242,6	243,6	265,5	283,1
Net profit (reported) (m)	-9,8	114,0	141,0	153,0
Net profit (adj.) (m)	-40,7	130,1	142,8	154,9
Cash flow (m)	124,7	210,4	245,5	264,2
Net debt (Cash) (m)	613,0	507,5	466,6	426,3
Gearing	53,1%	42,1%	36,5%	31,5%
ROCE	8,0%	7,7%	8,2%	8,6%
ROCE / WACC	1,4x	1,0x	1,0x	1,1x
EV / Sales	1,92	1,23	1,24	1,19
EV / EBITDA	10,18	6,55	5,91	5,45
EV / CE	2,0x	1,2x	1,1x	1,1x
P/E (adj.)	15,4	12,6	11,5	10,6
PEG (adj)				4,2
P/CF	17,99	7,87	6,75	6,27
P/BV	1,94	1,38	1,30	1,23
Dividend yield	2,9%	4,4%	4,8%	4,9%
EPS (adj.)	0,79	0,72	0,79	0,85
EPS (adj.) growth	-15,9%	-9,5%	9,8%	8,4%
CFPS	0,68	1,15	1,34	1,44
BVPS	6,28	6,56	6,94	7,35
DPS	0,35	0,40	0,43	0,44
Abs. Performances(12m,6m,3m,1m):	-13,7%	49,3%	-4,9%	-1,3%
12 month High/low: EUR.11 / .06		Avg. Daily nb traded shares:440000,000		

Main shareholders: Edizione Holding e Gilberto Benetton:69%; Free float:31%;

Adj.: excluding goodwill and extraordinaries. All share prices at 11/09/03.

BENETTON Price (short and long averages) Codes:BNG.MI/BEN IM



05

Distribution Decisions

* * *

Benetton is arguably the world's largest retailer with a network of 6000 large stores, smaller branches and franchises in 120 countries, worldwide. The company trades on the basis of Just-in-Time coloration and finishing providing flexibility to consumer demand.

From the very beginning, Benetton decided to maintain direct control of the logistics phase and has invested heavily in automating logistics processes in order to achieve total integration within the production cycle, from customer orders to packing and delivery.

Benetton is an Italian clothing manufacturer with sales of € 1.9 billion in 2002. The company distributes mainly through third-part independent retailers, but is currently developing its own retail network. It generates 69% of sales in Europe, 9% in North America, 9% in Asia and 13% in the rest of the world. Italy is Benetton's single largest market accounting for about 31.1% of sales.

Benetton's distribution strategy revolves around a large network of independent franchises and resellers who invest capital in their own network of stores (totaling roughly 5,200 at the end of 2002). These in turn buy merchandise from Benetton and sell directly to the retail customer. Benetton does not impose very strict rules on the independent distributors regarding the presentation of merchandise, completeness of range and general store ambiance.

Off course, this strategy creates a number of risks for Benetton. First, the company has less control over product positioning and the way merchandise is presented to consumers. This raises the risk of inconsistencies and variations in consumer perception to the detriment of the overall brand. Second, relying on third-party distribution weakens business intelligence and customer feedback and generally creates a less responsive business model.

The firm's spectacular growth is also underpinned by a unique organizational system, much studied by management gurus. Benetton sees itself as a "clothing services company" rather than a retailer or a manufacturer. Its customers are its shops, which are owned by outsiders. Unlike normal franchise systems, the shops pay no royalties and Benetton accepts no returned stock. A network of 83 area agents knits the whole operation together, finding investors for the shops and keeping Benetton's head office near Treviso in touch with customer tastes around the world.

Benetton does not plan to compete directly with its independent third-party distributors who form the backbone of the company's distribution. Rather, the retail investment programme is aimed at driving the overall appeal of the Benetton brand by opening a combination of larger flagship stores in leading locations such as New York's 5th Avenue and smaller stores in strategic locations. At the end of 1Q 2003, Benetton had 232 stores. Of these, 100 are operated directly by Benetton and 132 are run by independent franchises. Although Benetton does not disclose the breakout of

retail and wholesale activities, it is estimated that the retail business is currently loss making and will continue to be so for the foreseeable future. According to management, the purpose of the flag-ship stores is to enhance the overall brand. As such, losses on the directly operated stores can be viewed as additional marketing expenditure.
Despite the dilution of the total operating margins in the Casual division from the retail business and the significant investment requirements over the next three years, we view the development of a tightly controlled retail infrastructure as crucial to the reinvigoration of the Benetton brand and a return to revenue growth. A point not always appreciated by investors is the fact that with the bulk of revenue coming from wholesale rather than direct retail, Benetton's short-term fashion risk is arguably lower than for companies such as Hennes & Mauritz, Next and Marks & Spencer. According to management, around 70% of every collection is pre-sold six to seven months before the start of a season to the independent third-party retailers who distribute Benetton's product. Consequently, a large part of the fashion risk is carried by the independent distributors. However, this element of insurance against fashion risk is likely to be relatively short term. If a collection does not sell during a season, the independent distributors will likely reduce their future buying from Benetton.
It is believed the position of Benetton's main UCB brand (61.6% of group sales in 2002) is precarious against the backdrop of potentially weaker consumer discretionary spending and intensifying competition. The results of a price survey in suggest that Benetton's price points are relatively high. Relatively high price points are more at risk in the face of potential weakness in consumer discretionary spending.
It is believed that Benetton is mired in low growth and will struggle to drive the top line in the face of greater competition and potentially weaker consumer discretionary spending. Specifically, it is forecast no growth in the wholesale business during 2004–06. For the Retail business, investments in directly operated stores will drive a CAGR of retail revenue of 5.3% during 2004–06. Furthermore, there is some estimation that total EBIT margins in the Casual division will stabilize at 16.4% in 2006. This is significantly below the EBIT margins in excess of 20% achieved in the Casual division before the expansion into retail. For the Wholesale activities in 2006, it is estimated a slight margin contraction from 21.0% in 2002 to 19.5%, as a result of weaker pricing.

These assumptions underlying this casualwear forecasts are based on:
1. A 4% cut in average prices. This aggressive commercial policy should allow volumes to hold up well in spite of the difficult market (+3.5%).

2. Negative currencies (-3%) that will also impact the divisional EBIT[1] (which we have cut by €17 million versus our previous estimate, to be recovered below the operating line as a foreign exchange gain thanks to the hedging policies).
3. A favorable mix (product and channel).
4. Lower production costs thanks to increasing delocalization and outsourcing (an extra 10-15% to add to the current level of 50%), which will be fully on-stream in 2004.
5. Cost savings: following the exit from sports equipment, the Company is fully reviewing the organization and processes.
6. A retail loss at €31 million as a consequence of the number of new openings exceeding the up-and-running stores to be transferred to franchisees. Retailing is not an area of focus for the Group, with the real mission lying in upgrading the distribution network. This explains why Benetton is financing the franchisee UniCredit Banca Mobiliare Benetton Group (€775 million to date, of which some €450 million are tangible assets and €325 million are intangibles), and leasing some back to third party entrepreneurs once on stream.
7. Lower wholesale margins at 19.2%, mainly due to the negative impact of currencies and partly as a consequence of the lower price policy.

Over the past four years the company has gone through a massive investment in the so called "commercial development plan", which has the aim to reach two targets in one shot: enlarge the average size of the group's stores and directly control the best locations world-wide. The group so far has invested € 775m, out of which around € 450m in real estate assets (stores). As the family has already declared its intention to re-focus on its original core business (which is producing apparel to be sold through a network in franchising), it is clear that Benetton does not need to own stores directly (as it is not a real estate company) and that, it is likely it will proceeds to a spin off at the end of the investment plan. On the other hand, a higher degree of delocalization of the production into Eastern countries might free a portion of the industrial real estate. It is assumed that a potential disposal/spin off of the industrial properties might occur but only at a second stage. So, the best way to unveil the hidden assets is through a spin off.

Operating Margin should improve thanks to:

1. Lower losses of the sport equipment division (the sport business posted around €28m of operating losses in 2002 including a slightly positive contribution coming from the sport apparel business of around €5m)
2. Lower losses in the retail division (down from €40m to €36m in 2003 and €20m in 2004) we believe that the current DPS is sustainable however we need to underline that the 2002 DPS was down for the fifth year in a row. We expect apparel sales (ex retail) to decrease 2% The Gross Margin is expected to stay in line/marginally improve compared to 2002

[1] EBIT: acronym for Earnings Before Interest & Tax.

3. Lower contribution coming from the apparel business (we expect the operating margin to go down from 20.9% in 2002 to 19.4% in 2003 and 2004).

However in absolute terms we expect 2003 operating profits in line with last year. The EBITDA should be slightly lower than last year as the EBIT was previously impacted by high goodwill amortization charges related to sport equipment business. 2003 net financial charges should decrease marginally compared to the current year thanks to a lower net debt and the issue of a new bond. Conservatively we have posted no foreign exchange gains as we believe that any impact in the operating profits because of currency swings will be mainly neutralized by higher/lower foreign exchange gains. The company believes that the provisions posted in 2002 will be enough to cover the disposals of Prince and Nordica, accordingly they don't expect additional extraordinary charges to be posted in 2003.

06

Promotion Decisions

6.1. The Campaigns

Now more than ever we live in a society driven by image. Every day we buy less and less product and more and more image. It's not a sweater, it's a Gucci. It's not a pair of jeans, it's a pair of Levi's. Everything has been reduced to labels. Objects don't have an identity unless they are branded. One brand stands out from the others not by so much by product design but as by marketing strategies.

And one of the companies responsible for this is United Colors of Benetton. By choosing not to directly advertise their clothing and apparel, and by approaching social issues such as racism, AIDS, child abuse etc. they wanted to show that this is one company that is not interested in the products but in the people wearing them. That they were available for anyone no matter their skin colour, class, living region, social background or sexual preference.

To talk about Benetton’s promotion and advertising means talking about one person: Oliviero Toscani.

When it comes to promotion, Benetton are in a class of their own. Since the company was founded in 1965 it had no real advertising. All this changed in 1985 when Benetton hired Oliviero Toscani as marketing director, and, furthermore, gave him complete control over the advertising strategies. Benetton offered their billboards as blank canvases for his art.

Toscani had a very simple recipe: take a powerful image, stamp the logo in a corner and there you have it. The ad will work by itself from that point on. He wanted no marketing research, he saw no need for ad agencies. Toscani single-handedly built and established the image of Benetton as one of the most recognized brands worldwide. This made advertising people from around the world look at him with admiration and envy at the same time. ‘I take pictures, I don’t sell clothes’, he claimed. He did not try to seduce the buyer with smooth, heart-warming imagery or by whispering sweet little nothings in the subconscious.

This type of passive-aggressive advertising pushed Benetton from a small-time sweater manufacturer somewhere in Italy, to a worldwide corporation, handling billion-dollar contracts. No campaign has ever come across un-noticed. Some might say that this has not done well to the image of the company. Others say that as long as the company brand was heard of, that was enough (the same people that say there is no such thing as bad publicity).

Toscani's most well known motifs were:
- Dying AIDS patient
- Priest kissing nun
- T-shirt of Bosnian soldier (with bullet holes and blood stains)
- Military cemetery with Star of David
- Ship with refugees
- HIV positive tattooed
- Oil polluted duck
- Newborn child

What do these motifs all have in common?
- they are part of an image campaign for the Benetton company;
- they are not related to a product produced or marketed by Benetton;
- they do not contain any request to buy a Benetton product;
- the only wording they contain is the slogan and brandname 'United Colors of Benetton';
- they use subjects of recent political events;
- they show religious manifestations;
- they address severe social and environmental problems;
- they use erotica.

In 1985, Toscani launched the 'Flags' campaign, featuring children wearing flags, such as: US and USSR, Israel and Germany, China and US, Argentina and Great Britain. This was Benetton's second campaign under the art direction of Toscani. In the first part of the campaign, the two children were usually black and white. This was followed by a second part, which included also pictures of Arab and Israeli, Japanese and Chinese, Brazilian and Scandinavian children. This second part of the campaign, named 'The United Colors', lead to the slogan United Colors of Benetton, which became the trademark of the company ever since.
Although the US was not at all pleased with this kind of advertising, thus banning it, the campaign was very popular in Europe.
The first signs of what will later be called 'the Benetton phenomenon' were beginning to appear in a world of unsuspecting advertising companies and consumers.

In 1989, with the 'Contrast in Black and White' campaign, Toscani's advertising style evolves to the point where he becomes a militant for racial campaigns. This is also the first campaign in which 'The United Colors of Benetton' evolves from the company slogan, to the company identity, with a new logo. On the philosophy that less is more, a simple green rectangle with the text written in it, this new logo became one of the most recognized in the world. Unlike Adidas' transition from the three-leaf logo to the three-stripe logo, upon which the three-leaf logo of Adidas has gained cult status, Benetton's logo transition did not bring cult status to the former identity.

The 1991 campaign revolved around a photograph called 'War Cemetery', featuring a cemetery in France with long rows of symmetrically aligned identical crosses, a simple yet striking image. The message was simple: in war, beyond uniforms, ranks, races and religions, death is the sole victor.
The image appeared in the Italian press a few days before the start of the Gulf War. The ad was immediately banned by the Giuri, a self-regulatory committee set up by Italian advertising companies. After long debates worldwide, the picture was banned also in France, Great Britain and Germany.

Then it was a black woman breast-feeding a white baby; then a priest kissing a nun; then a new-born baby, blood-smeared, umbilical cord still attached. All these campaigns generated many reactions, mostly rather negative than positive, but they did what they were meant to do in the first place: put United Colors of Benetton on the fashion map.

When the campaign featuring an AIDS victim was released in 1992, everyone thought the company has gone too far. This was the beginning of what Toscani called 'reality advertising', featuring real photographs taken by real photographers. This new style of advertising was meant to expose the public to real issues, and themes that most people would never like to deal with: illness, death, forced immigration, violence, intimidation.
This particular advert was considered by Britain's Advertising Standards Authority as 'obscene', 'disgusting' and 'a despicable exploitation of a tragic situation.' And like many times before billboard companies, publishers, newspapers and magazines refused to run the photo.
The image of a dying AIDS victim is arguably the most controversial that Toscani ever used for Benetton. The emaciated Christ-like figure of David Kirby (the AIDS victim) is contrasted with the fleshy obesity of his family gathered by his bedside in an Ohio hospital room. Its impact is all the more brutal because it exposes such an intensely private and emotionally painful moment and the grief of the family members is as uncomfortable to see as the agony of the dying man - the reality of AIDS.
Despite all the negative reactions in Europe, Benetton was not undaunted, perhaps even encouraged, to unveil the ad in New York. The reactions in the US were similar to those in Europe.
After this campaign, Benetton followed up on the AIDS theme in the next years, but using images that were somewhat more toned down, keeping controversy at a manageable level.

Another campaign that raised havoc in newspapers worldwide was featuring an image of the bloodstained military uniform of a dead Bosnian soldier, Marinko Gagro. An increasingly hostile press was anxious to discredit the work and cause a scandal. Die Woche investigated and claimed that Gagro's father had never seen the clothes in which his son died. He believed that they were burnt in hospital and that they would not have been handed over to anyone.

Toscani was somewhat compromised when it emerged that Gagro had been killed by a grenade splinter that hit him in the head, whereas the t-shirt of his alleged uniform had a bullet-hole. Toscani said the clothes had been posted to him in a cardboard box. It was evident that in future Toscani would have to act with greater caution.

Up to this point in time, the advertising campaigns for Benetton were extremely cheap, the company spent only 4% of the income on marketing. Toscani managed to get worldwide recognition for the brand Benetton using pocket change.

This changed in 2000, when Toscani initiated an expensive project called ‘Sentenced to Death.’ It was inevitable, that having survived so many scandals, eventually Toscani's luck was going to run out. That day arrived with the launch of the 'Sentenced to Death' campaign, the culmination of a €20 million investment and a two-year period spent touring American state prisons and interviewing prisoners on Death Row.

The 27 prisoners interviewed appeared in a glossy insert "We on Death Row" run in Talk magazine. Each individual looks to the camera with the slogan 'Sentenced to Death' above their head along with personal details in small print including, name, crime and means of execution.

When seven of the prisoners were selected to appear on posters across the US, the State of Missouri filed a lawsuit against Benetton, claiming they had been misled and would never have allowed access to the prisoners as part of an ad campaign.

Under pressure from victim's rights groups such as Parents of Murdered Children (POMC), retailer Sears Roebuck buckled and severed its distribution contract to sell a specialized Benetton USA line in 400 stores. Although it accounted for only a small proportion of Benetton's worldwide sales, Sears' withdrawal rendered a significant blow to its attempt to penetrate the US market and sent ripples of unease elsewhere. Toscani, somewhat wistfully, concluded: ‘I had hoped the Americans would be more courageous.’

In 2000, Oliviero Toscani left Benetton after many years of leading the Italian clothing maker's controversial advertising. Toscani, 58, has recently been director of Fabrica, Benetton's communications research centre in Treviso, Italy. The company was not decided whether to fill his position, so they issued that Fabrica's creative teams can carry out Benetton's ad plans for about a year. Benetton official press release stated that ‘Toscani's departure was not a result of the firestorm that greeted [the Death Row campaign].’ This campaign was longer running in the U.S., but continued to roll out in Europe throughout that year.

6.2. Toscani's Legacy: Fabrica

The school was housed in a 17th-century villa close to the Benetton Group factory in North-east Italy. Fabrica - the name is a play on the Italian word for factory - opened in May 1995 to 50 students from art schools all over the world.

People aged under 25 from all over the world apply to Fabrica to study a range of disciplines including music, cinema, video and graphic design and to produce editorial for publications such as Benetton's Colors magazine. It is overseen by an "international scientific committee" that consists of promising students kept on by Toscani.

Since Toscani's departure, Benetton's ads have featured - shock horror - models wearing knitwear. But more recently there has been a return to the more familiar territory of advertising with a social conscience and extreme imagery. A current ad, promoting Benetton's involvement in the World Food Programme (WFP), shows a man with a crude prosthetic spoon attached to his mutilated arm.

Another ad in Fabrica's WFP series shows Basima, a 16-year old Afghan girl supported with food aid in Afghanistan, who now hopes to find work as an embroiderer in Kabul. Some would say that this proves the Toscani approach to be predictable, formulaic and easily recreated in the absence of the man himself.

Others will argue that it pays homage to a revolutionary who blazed a brave new trail in marketing communications. Either way, it seems that the Fabrica team is following the example of their former mentor once again.

Benetton claims Fabrica has been independent up until now. Students could work on projects for both profit and non-profit organisations on a take it or leave it basis. They could retain their "artistic integrity" because they were not under pressure to earn money for accounts as Benetton resources the centre.

And for the first time, Benetton began to insist on the video promotion, not only print. Noted Chinese film director Zhang Juan shot the TV ads in the U.S. with 10-, 15-, 30- and 60-second formats slated to deliver a multicultural concept with a Chinese accent. The spots were aired in theaters as well as on television.

In 2001, Benetton spent an estimated $80 million on ads, including print and billboard as well as Fabrica R&D, Colors magazine and Catalogs. The company spent $3.4 million on ads in the U.S. in the first 10 months of year 2000.

6.3. Colors

In 1994, Benetton decided to do what other 200 companies already did: create a magazine, so they came up with Colors. What was different about Colors than from other corporate magazines? It was launched on a global scale, in order to be in sync with the entire United Colors of Benetton philosophy.

Although the company did not say exactly how much they invested in it, with a print run of 800,000, distribution in more than 100 countries, correspondents in 29 countries, text translated into six languages and plans to increase the number of issues each year from two to four, it was probably a very expensive concept.

What can Benetton gain from a lavish publication, which, like its notorious ads, covers controversial issues such as racism and the environment? Whereas, arguably, the ads pay for themselves by gaining a lot of extra publicity in the media, Colors could be seen to be just a massive drain on Benetton's resources. In order to reduce the drainage of Benetton's resources, Colors accepted advertising, there was no way it would ever become self-financing, as the editors claimed.

'The idea is to transmit a world view, a society view for the company,' the director says. 'When people buy something now they want to know what's behind it, the philosophy. We expect to make it clearer to the public where we stand and what we think.' The ad campaign was designed to raise issues, but Colors will articulate what Benetton thinks about these issues.

The official press release stated that Colors 'is a magazine that's meant to try to be the first truly global magazine. It is for young people, by which we mean college students, give or take five years, around the world.'

No one can know how much brand recognition Colors generated for Benetton, but surely Colors was a success because of its Benetton roots.

6.4. Losing Identity

After Toscani's leaving in 2000, the company turned to the 'classic' methods of advertising, although still mildly touching racial issues. The worldwide fame of Benetton is all owed to Toscani and his style that influenced so many other artists and advertising people. After his departure, the company's prestige and uniqueness slowly faded out, now being no more that just another expensive clothing manufacturer. Only a few still hold reminiscent memories of the glorious days of the United Colors of Benetton, a once powerful brand.

Since 1984 wearing Benetton clothing was not just an act of covering the body or dressing nice, it was a statement. A statement that he or she wearing them is an open-minded, modern person. This mentality was achieved by the highly inspired and original advertising directed by Toscani. Every campaign they have launched under his direction always attracted an enormous quantity of attention and almost every poster or billboard they had put up attracted many reactions.

Their campaigns have introduced new words in the advertising language, words such as 'shockvertissement' and 'reality ads.'

Today the brand Benetton no longer stands out from other clothing and apparel manufacturers which is also showed the lower profits they get every year. So they still have quite the ethnic diversity in their promotion, but in today's modern society this is no longer something to frown upon, but a necessity. So their billboards continue to be simple and not so commercially intensive, but if this is not backed up by a powerful story, the effect is almost null.

The advertising society, especially in Europe, has reached a point where simple commercials, that directly try to convince the buyer to buy a product or service, no longer work. The buyer has become quite an intelligent breed, they do not want other people telling them what to buy, and they want to be convinced by arty commercials, smart ads a company philosophy they relate to. And because Benetton didn't change their advertising style since 2000, everyone got used to it and even grew tired of it. Their simple portraits with white background just don't cut it when faced with the aggressive and intelligent campaigns by rivals such as Nike, Adidas, Puma and Reebok. Even though Benetton like to think of themselves as above this 'sport & leisure wear' league and into the Marks & Spencer, The Gap etc. 'lifestyle wear' league, the lack of a strong identity places them somewhere in between.

Some people would rather see Benetton maintain the controversial ads. In Britain, when the new, happy-faced ads broke early in 2001, they were panned as 'so innocuous as to be invisible.' Even though these new ads were made by his disciples at Fabrica, Oliviero Toscani was even more dismissive. ‘It's a waste of money,’ he said.

Bitterly attacked by some and internationally acclaimed by others, Benetton’s campaigns are not only a means of communication but also an expression of our time. At the same time they have paved the way for innovative models of transmitting corporate ‘intelligence.’

In the end, some might say that it doesn’t matter what the critics said, that the campaigns were ‘tasteless,’ that the company was exploiting the world’s problems to create their image. It doesn’t matter that Toscani said that the ads were only trying to raise awareness on social and cultural issues. What matters is that the Benetton brand was built on petty cash and in a very short time frame; it is now among the world’s best known brands, and this was achieved in under 20 years by one photographer, only print ads and billboards, no advertising agencies, no television commercials.

07

Pricing Decisions

* * *

Benetton has had an uneven cash flow profile over past five years with significant acquisition and disposal activity. Taking cash from operations less working capital requirements, it deducts only investments in tangible and intangible assets. It excludes acquisitions, disposals and financial investments. It expects to see continued investment in the retail infrastructure combined with working capital requirements to drive continued low cash conversion on EBIT. A continuation of the relatively limited appeal of Benetton's merchandise combined with potentially weaker demand for clothing could lead third-party retailers to demand more favorable payment terms. If Benetton's management cannot restore an element of "must have" and a sense of fashion to the brand, Benetton's bargaining power with the independent retail distributors could seriously weaken the company's position. We assume an increase in working capital requirements, with days sales outstanding increasing from 146 in 2002 to 174 in 2006.

Benetton generates relatively low returns on both equity and capital employed. The foray into sports equipment has depressed margins and although the company is in the process of divesting three of its sports brands, it is estimated overall group profitability will improve only marginally. Furthermore, the asset base to remain relatively high as a result of investments in the retail infrastructure combined with an increase in working capital requirements.

Benetton has a strong competitive advantage in its supply chain, with flexible production and both a state-of-the-art distribution centre and logistics. However, it is said that the supply chain is not optimally leveraged: Benetton would be well positioned to produce fashion-forward merchandise (since much of its production still takes place in-house and in Europe, close to its distribution network) and could therefore respond relatively rapidly to fashion changes. However, the lack of direct control over its distribution network (as most stores are run by franchised partners) makes it difficult for Benetton to implement effectively the information flows and feedback loops needed to sell merchandise with a high fashion content and with the appropriate levels of risk.

The business has become more capital-intensive, with the addition of directly operated stores since FY (fiscal year) 2000 and the investment in real estate on behalf of the company's franchisees. The move to upgrade the distribution network via megastores and directly operated stores required significant investment (roughly €750 million to date), but the financial and brand benefits of that investment are not visible (since the start of the programme, Benetton's revenues have increased by just €160 million. A spin-off of the group's real estate holdings has been highlighted by management in the past, but this will not happen until well into FY 2004.

During Q1 2003, the negative impact of currencies on Benetton's sales was roughly 3.8%, as a result of the strength of the Euro versus the US dollar, the Yen and sterling. We are assuming a negative currency impact in sales for FY 2003 of roughly 2-3%. In terms of costs, the bulk of COGS, as well as operating costs, are in euros, although raw material prices (mainly cotton and wool) are somewhat linked to the

US dollar. Overall, we estimate that close to 90% of the group's costs are Euro denominated.

Casual division sales were €340 million, broadly flat on Q1 2002, but up 3.8% excluding the negative impact from currencies (owing to the strength of the Euro). The 4.3% gain in volumes was likely driven by the price cuts applied to the Spring/Summer 2003 collection (of roughly 4%), while a favourable mix added 3.4% to the growth. EBIT reached 0.47 million, down 6%, implying a 100 bps margin contraction for the casual division (from 14.8% in Q1 2002 to 13.8% in Q1 2003), driven mostly by the impact of adverse foreign exchange movements in gross margins (excluding the currency impact, EBIT margins were 14.8%, in line with Q1 2002). Losses from the retail operations improved to 0.9 million (vs 0.13 million in Q1 2002), on sales of 0.35 million, generated by 100 directly operated stores (DOS), versus 92 DOS in Q1 2002.

<u>2004-2005 estimates:</u>

Deconsolidating the sports brands leads to decline in revenues in FY 2003 and FY 2004, on the estimates. Much of the EBIT growth in FY 2003 comes from lower goodwill amortization; FY 2002 saw large extraordinary charges related to the disposal of the sports brands. The ongoing move to shift production outside of Italy should lower manufacturing costs and contribute to better gross margins in the long term

These current estimates do not include any of the possible benefits from the actions that the new management are to implement. Hence, while neglecting any major growth at the top line level, it is assumed that the major driver for Benetton's performance will be a recovery in operating profitability. In fact, the Group should benefit from a reduction in capex and from maturing stores, which should at least halve the retail losses from €40 million in 2002 to €20 million in 2005. On the other hand, even if management successfully implements a small part of the projects expected, this should translate into faster sales growth, which in turn should have a proportionally higher impact on margins via the operating leverage. Cash flow generation should also continue at a sustained pace. Assuming average capex of €110-120 million per year in the next two years, it is expected an average free cash flow of €130-140 million per year.

Table 1. Benetton Group -2003-04 Casual Estimates (€m)

	2003E	Yoy change	2004E	Yoy change
Wholesales	1 424	-1.5%	1 464	2.8%
Retail	142	1.1%	164	15.8%
Total Casual Sales	1 566	-1.3%	1 628	4.0%
Wholesales EBIT	273	-10.1%	315	15.1%
Retail EBIT	-31	n.m.	-27	n.m.
Total Casual EBIT	242	-8.2%	288	18.7%
Wholesales Margin	19.2%		21.5%	
Retail Margin	n.m.		n.m.	
Total Casual Margin	15.5%		17.7%	

Table 2. Morgan Stanley Woman's Weare Price Comparison Survey

Price comparison	Matalan	H&M	Zara	Per Una (M&S Brand)	Benetton	M&S	Next
White T-shirt	5	5	5	12	10	9	10
Jeans	10	20	29	35	35	36	25
Summer Top	8	6	12	10	10	12	5
Smart Trousers	9	15	45	30	29	29	36
Basic Suit	35	55	125	90	90	125	135
Cotton Shirt	6	10	9	20	25	25	22
Summer Dress	13	10	18	40	40	40	40
Female Underwear Set	8	10	17	14	27	18	20
Beach Sandals	3	4	12	25	13	18	17
Evening Shoes	9	10	50	45	39	35	45
Leather Handbag	9	8	45	30	45	36	35
Bikini	8	12	17	35	29	19	24
Total Basket	123	165	384	386	392	400	413

Table 3. Benetton-First Quarter (1Q) Comparison 2002-2003

	Q1 2002	Q2 2003	%change
Total revenues	447	444	-0.6
Gross profit	200	192	
Gross margin	44.9%	43.2%	
EBITDA	79	80	1.3
EBIT	45	54	19.5
EBIT Margin	10.1%	12.2%	
Tax	-18	-24	33.3
Tax rate	48%	49%	
Net income	19	25	31.6
EPS (€)	0.11	0.14	31.4

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Appendixes

A. Edizione Holding

Edizione Holding is the Benetton family's holding company. Based on the international market experience of the Benetton Group and being aware that efficiency and speed of communication are fundamental elements in the creation of value, Edizione has developed a network of companies aimed at offering quality goods, services and infrastructures for modern consumers and people on the move. These companies operate all over the world, in various sectors: clothing, both casual and sportswear, which constitute, with the activities of Benetton Group, the traditional and innovative "heart" of the system; highway and urban catering services; infrastructures and services for mobility and communications; real estate and agriculture; other activities, such as the industrial investments of 21, Investimenti. In total, aggregate turnover exceeds 7 billion euros. The total number of Group employees exceeds 50,000.

Benetton Group

Today, the Benetton Group is present in 120 countries around the world. Its core business is clothing: a group with a strong Italian character whose style, design expertise and passion are clearly seen in the United Colors of Benetton and the more fashion-orientated Sisley brands; in The Hip Site, the brand for teenagers; and in sportswear brands Playlife and Killer Loop. The Group produces over 100 million garments every year, over 90% in Europe. Its retail network of 5,000 stores around the world is increasingly focused on large floor-space points of sale offering high quality customer services and now generates a total turnover of 2.0 billion euros, net of retail sales.

Highway and Urban catering Autogrill

Autogrill, the world leader in catering services for travellers, is present, also through the American subsidiary Autogrill Group (the former HMSHost), in 14 countries worldwide, with a network of over 4,300 sales and catering outlets, distributed in around 900 locations on highways, in airports and railway stations, as well as in exhibition, shopping and town centres. The variety of services offered (from snack-bars to self-service restaurants, from quick-service pizzerias to coffee shops, from hamburger restaurants to latest generation sandwich bars) and the many brands owned (such as Ciao, Spizzico and ACafe) or under licence (including: Starbucks, Burger King, Sbarro and Pizza Hut) constitute a portfolio of products which is unique in the world in terms of breadth, competitiveness and impact. Total turnover exceeds 3 billion euros. Every year in the Group's establishments over 690 million customers are served with 240 million meals, 260 million cups of coffee, 55 million slices of pizza, 85 million sandwiches and 175 million drinks.

Infrastructure and services for transport and communication Autostrade

Autostrade is Europe's largest toll-highway manager. Its strategic position in the centre of Europe makes it an essential part of the European highway system, in particular along the route from the north to the south of Europe, Rotterdam-Bari, and the east-west route Lisbon-Kiev. For the next five years, the company has outlined an investment strategy of around 10 billion euros, to be used in important new infrastructure projects, the enhancement and modernisation of the existing network, the creation of new stretches of highway and infrastructure for inter-modal exchange. In Italy, Autostrade manages, directly or through related companies, a network of over 3,100 kilometres, with a turnover of around 2.5 billion Euros.

Olimpia

Olimpia is the main stockholder of Telecom Italia, the largest Italian group and one of the main world telecommunications companies. Edizione Holding owns 16.8% of the capital of Olimpia with its industrial partner Pirelli (50%). The remaining capital of Olimpia is divided between Hopa (16%) and the banking groups IntesaBCI and Unicredito, with around 8% each.

Grandi Stazioni

Redefinition of the social and economic role of railway stations, with particular reference to the architectural areas and services offered: these are the objectives of Grandi Stazioni, in which Edizione, together with partners such as Pirelli, the Caltagirone Group and SNCF (French railways), holds 40% through Eurostazioni. The project involves 13 of the largest Italian stations, with a total of 700,000 square metres and used by more than 600 million people a year. Roma Termini is the first station where work has been completed, with over 100 shops opened.

Sagat

Sagat, in which Edizione holds 24% of the capital, is engaged in the management of Turin airport and recently acquired 29% of the company which manages Florence airport. Turin and Florence are part of a project which aims to construct a network of integrated Italian airports, with a strong capacity to offer modern services and high added value.

Real estate and agriculture

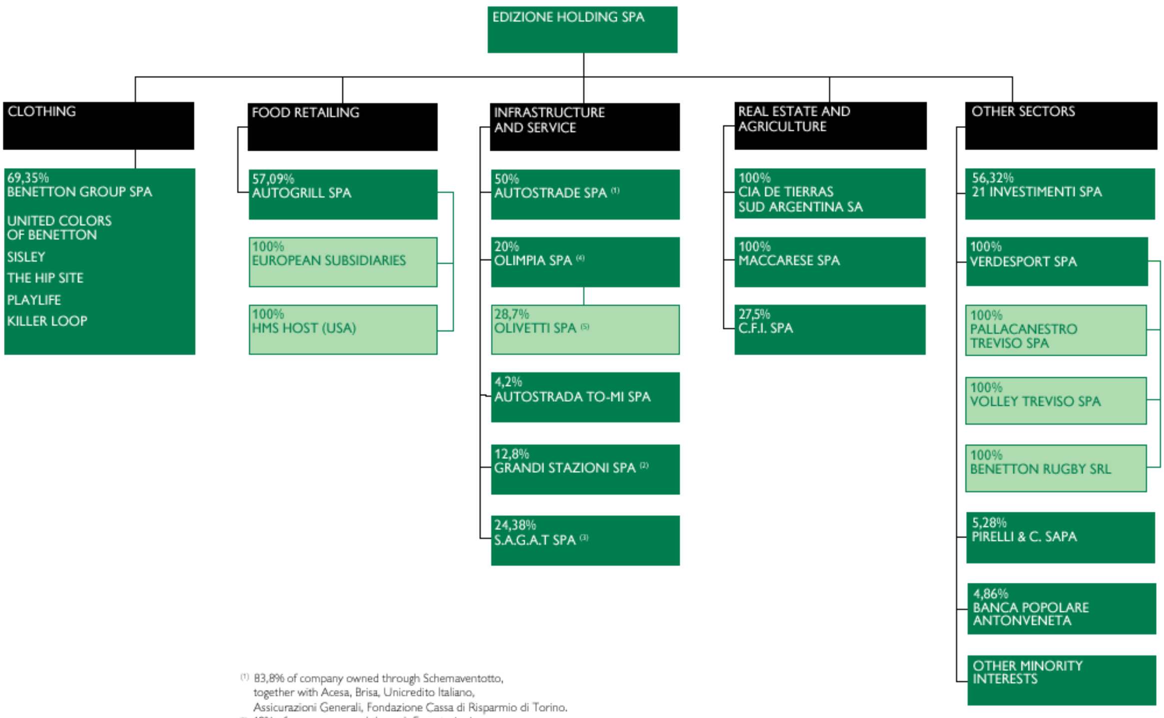
Edizione Holding owns and manages real estate assets in the principal Italian, European and American cities, as well as large agricultural enterprises in Italy and Argentina. The Argentinean holding in Patagonia extends over an area of around 900,000 hectares, with over 280,000 head of livestock. The most significant real estate operations in recent years, in Italy, include purchase of the Hotel Monaco Grand Canal in Venice, opening of the Relais Monaco (formerly Toulà) near Treviso, construction of the Asolo Golf Club, one of the most prestigious in Europe, and acquisition of the 3,000 hectare Maccarese estate at the gates of Rome.

Other activities

The subsidiary holding company of Edizione Holding, 21,Investimenti, set up as a merchant bank, is now a satellite system of closed investment funds with an industrial approach which focuses its business in minority holdings in medium-size companies with high growth potential. Its stockholders include IntesaBCI, the Seragnoli Group, Deutsche Bank, Fininvest and Assicurazioni Generali. 21,Investimenti represents a solid network of skills and international relations, able to focus its attention in those areas and countries which at a given time offer high development potential.

Edizione also has significant minority holdings in Pirelli & C. and Banca Antoniana Popolare Veneta.

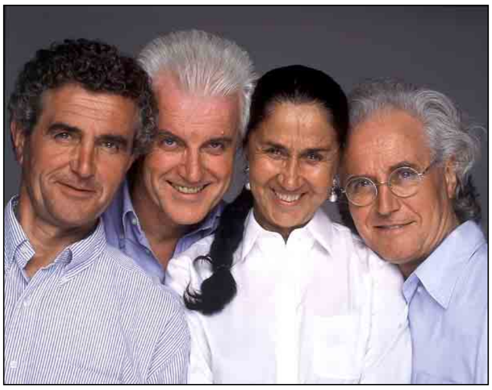
B. Organization Flowchart



(1) 83,8% of company owned through Schemaventotto, together with Acesa, Brisa, Unicredito Italiano, Assicurazioni Generali, Fondazione Cassa di Risparmio di Torino.
(2) 40% of company owned through Eurostazioni, with partners including Pirelli, Gruppo Caltagirone and SNCF.
(3) Company which runs the Torino Caselle airport.
(4) 60% of Olimpia is owned by Pirelli Spa.
(5) Olivetti owns approximately 55% of Telecom Italia Spa.

01/03/2003

C. Imagery



The Benettons

Interior view from a megastore

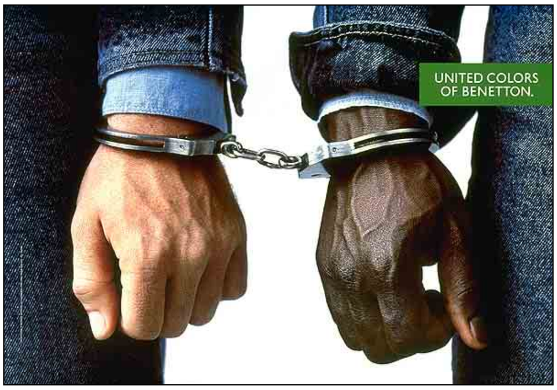
Sorting Line

Knitting Machine

The 'Colors' Magazine

Product Advertisement

D. The Billboards



Handcuffs / Oliviero Toscani / 1989

Children on Toilets / Oliviero Toscani / 1990

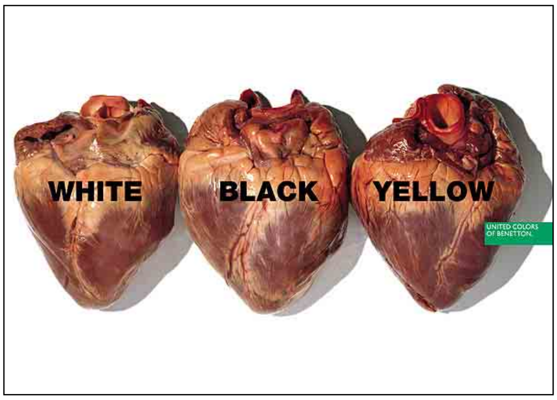
Cemetery / Oliviero Toscani / 1991

Newborn / Oliviero Toscani / 1991

AIDS / Therese Frare / 1992

Container / Robert Patrick / 1992

Horses / 1996



Hearts / 1996

Food for Life / 2003

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