Are mergers and acquisitions in the fashion industry more likely to fail?

Tight wallet... but right style?

Except for those of us animated with a raging passion for it, we can all agree that fashion is not a necessity. That explains why when times get rough, the rough does not stop shopping... at least not clothes.

Consumer cyclicals are goods and services that are heavily dependent on the state of economy and clothing is one of them. Although, studies have shown that in times of recession, the fashion industry is one of the least impacted areas. As matter of fact, during the Great Financial Crisis, it enjoyed a decent growth compared to automobiles or housing. But it seems as though the industry does not know how to exploit that benefit to their advantage...

A McKinsey report published in 2017 stated that consumers’ trends and behaviors are becoming more and more tricky to anticipate especially when it comes to ours. Because apparently, we – millennials and undoubtedly the largest spending class in a few years - spend less and less on clothing. Here’s the trick: not in absolute value yet, the percentage of our bucket allocated to fashion keeps reducing to allow for spending on areas such as electronics and online subscriptions like Spotify or Netflix. And that may explain the increasing number of mergers and acquisitions attempted in the last decade by industry giants in order to keep their market shares and strengthen their positions.
Nevertheless, despite a quite satisfactory performance for the past decade, the fashion industry collapsed mainly due to issues internal to Europe such as terrorism attacks and Brexit. It thus broke the average growth rate of 5.5% it had been enjoying for ten years. But interestingly enough, when surveyed, a lot of executives in the industry seem rather hopeful about the future.

But is this optimism realistic?

**M&A in the fashion industry**

2017 set a new record for mergers and acquisitions in terms of transaction volume and worth with over 50,000 transactions totalling $3.5 trillions. Warren Buffet even stated in regard to M&A activities that:

“Mastering the art of deal making is what transforms an everyday company into a leading business empire.”

Are M&A activities and fashion like mixing stripes and polka dots? Of course, we’ve all heard of successful acquisitions such as the American luxury brand Coach buying Stuart Weizmann. But lately, claims are being made that mergers in the fashion industry are less likely to succeed than in any other industries. The main argument is that in the pharmaceuticals or oil and gas industries for instance, a lot of alliances are formed with the goal of revolutionizing the industry by creating value or combining resources to gain market shares. Whereas in fashion, the most recent acquisitions seemed rushed and constituted
survival strategies aimed at counteracting the new threats that have emerged. Abercrombie and American apparel are cases that perfectly illustrate that.

Overall, the pressure of huge amounts of affordable clothing brought by European retailers such as Zara or H&M as well as stores with an online-only presence have been threatening brands that have been around for over a century. We will later explore the example of Abercrombie and Fitch, which is a testimony of this phenomenon.

The example of Anthropologie and the critical importance of trends in this industry

One critical issue that the fashion industry is facing is its important cyclicity. A simple change of trends such as jeans being replaced by leggings could make or break a company whose excessive fixed costs make it ill-equipped to adjust almost instantly and turn its business around and start producing leggings. Anthropologie, the American retailer with stores worldwide experienced back to back declining sales for 4 quarters back to back and declared in March 2017 a 2.9% decline in comparable sales causing their share price to subsequently decline by 17%. The brand that has under its portfolio other brands such as Urban Outfitters and Free People admitted that they did not anticipate the sharp increase of demand for dresses and paid the price. It currently still trying to recover.

The fashion industry: then... and now.

One other change in habits in this industry brought in the 2000s is the switch from changing rooms to bedrooms offered by the convenience of e-shopping from the comfort of your own house. Besides, with free returns and shipping offered by main companies, this model is experiencing a raging success with a lot of success stories, the main being Amazon.

Also, the past decades gave rise to increasing sales, discounts of all sorts, loyalty points and special offers... to the point that consumers do not want to buy full price anymore. Why should they if they know that in a few weeks, someway of somehow there will be discounts available?

Therefore, we see that it is not so much a change in consumption volume but rather a change in customer habits that puts the fashion industry and the companies operating in it in a position where, even a well-thought merger cannot save.

¼ of the most important fashion private equity deals in the past year restructured or filed for bankruptcy. That occurs more in the US than anywhere else which is why, for a lot of brands, the resort lies in selling to European multinationals. However, given that 65-75% of M&A deals fail, a 25% failure rate for the fashion industry seems like a very good performance. And that is why I strongly believe that M&A deals in fashion are not less likely to succeed. In fact, they might even be more successful. However, due to the nature of the industry and the different trends that constitute the main driver, there is no longer room for creation of synergy or outstanding success.
The quest for acquirers

After making the strategic decision to “let go”, some companies face the issue of not finding acquirers. One must not forget that when merging with a company, the acquirer takes the good, the bad but also the ugly. Thus, one might just increase its risks by taking on a struggling business with a myriad of empty stores for instance. Abercrombie & Fitch is proof that it is nearly impossible in this business to find a buyer willing to pay the right price. This company that once was a success story with its original shirtless models standing outside the store and taking pictures with clients and tourists while luring them inside in order to spend their hard-earned money... or at least their parents’.

Today, the company has a lot of stores in every other mall all around the world.... But they are empty, as teens are now shopping at other brands that - they feel- appeal more to their style and to the current trends. A lot of things are to blame for the company’s fall down but the main one is that they were so popular for so long that they perhaps got too comfortable and did not adjust to trends rapidly enough. For instance, they kept offering apparel with their logos all over it (which was their trademark) a long time after the trend of “showing off” brands name or logos on everyday clothing died off.

Today, after having try to broaden its horizons to lingerie and even adult apparel, is driven by brands such as H&M to sell to competitors. However, no one seems to be willing to pay the price. Their stock is currently trading at $21.92 was once worth three times more.

Recently we are noting that the most successful M&As are the ones that involves young companies. Indeed, those have more room to grow and develop. There is also the possibility of making economies of scale as their supply chain can be optimized. Unfortunately, companies like Abercrombie and many others do not fall into that category as the reality is: there just is not a potential to exploit. Once the customers targeted feel like the company is unable to keep up with the trend, they start looking around and find themselves realizing that for every Abercrombie & Fitch, there are a few dozen companies offering similar items.

As Chris Ramey, founder of a consortium of luxury brands stated: “Consolidation is the natural order of capitalism,” and this is particularly true when it comes to retail. Because in an industry that is so stagnant, it is better for companies to acquire than to use up their already limited funds to invest.

In a nutshell...

Morgan Stanley believes that until 2060, Health Care, Entertainment and Housing will outperform apparel, education and transportation. That is mainly due to the change in spending habits of the largest generation in personal consumption, which accounts for 70% of the US GDP.
As successful as they are, the synergy of a successful merger will not undo the negative effects of an industry that is not growing. Are all M&A transactions destined to a terrible fate? No, but as investors, we should not expect them to thrive compared to other industries. It might be safer to bet on the ones mentioned above. I know I would. But then again, investing is not about safety, is it?

I do not believe that M&A in fashion are doomed or by nature less successful than that of the other industries as proven above. But I do believe that the economy has shifted in such a way that there is no potential for growth in that sector and that is where the paradox lies. On one hand, the idea is that corporations must unite and conquer but on the other hand, why unite if the outcome is almost insignificant and yields little to no synergy.


Values are relative to the average return across all sectors of approximately 0.77 percent.
M&As in fashion are like fashion itself, some people get it and some do not. And if you find yourself in the latter category, your inventories will be staying in your hands. Everyone needs clothes... but not everyone needs fashion.

Source:

- Yale Law School studies
- Financial Times References:
- “The State of Fashion”, McKinsey
- -Thomson Reuters
- “Generations change how spending is trending, Morgan Stanley:
- Deloitte M&A trend report, 2017

DISCLAIMER

About the article

This Article has been compiled by the author mentioned above and published by him via the EDHEC Student Finance Club (“Club” or “ESFC”) platform. The club confirms that the author is an active member at the time this article is published, but emphasizes the fact that opinions and views given by the author in this article are his/her own views. ESFC takes no responsibility for the completeness or correctness of information provided. No investment advice is given with the text above and the reader should not take any financial position based on the information published in this article. The Club recommends extensive research by the reader before investing in any financial asset.

General

The article may be based on the information extracted from various sources including but not limited to various companies' and statistical agencies' websites, online portals, third-party research, annual reports etc.

No representation or warranty of any kind is or may be made with respect to the accuracy or completeness of, and no representation or warranty should be inferred from, any projections or futuristic statement contained herein or any underlying assumptions.

This article may include descriptions, statements, estimates and projections/futuristic statements with respect to current and anticipated performance of the underlying.

Such statements, estimates and projections reflect various assumptions and best estimates made by the participants concerning anticipated results, which assumptions and estimates may or may not prove to be accurate or correct. There are no assurances whatsoever that any statements, estimates or projections contained in this article, including without limitation any financial or business projections, accurately present in all material respects the underlying's financial and/or business position as of the respective dates specified and the results of its operations for any respective periods indicated.

No copyright or trademark infringement is intended in any form.

© Copyright 2017. EDHEC Student Finance Club