Restructuring in Fashion: Challenges and a potential way out of the crisis

Victor Seuwen asks what can fashion companies do to be among tomorrow's winners?

VICTOR SEUWEN
Partner, EOC Operations+
Consulting GmbH, Germany

For decades, the global fashion, apparel and luxury sector has outperformed other industries with double-digit growth. Nowadays, while global market growth is expected to continue until 2020, the fashion industry is at severe crisis for multiple reasons.

Besides facing the dilemma of balancing sales growth against margin improvements, which are inherent to the fashion industry, companies are now exposed to dramatic changes in the market dynamics. These shifts create significant implications in the way companies create value and establish the margin level. We have identified the major influences which have caused the industry's current crisis and assembled a potential approach in finding a way out.

"THE CURRENT CRISIS OF THE FASHION INDUSTRY STEMS PRIMARILY FROM INCREASED MARGIN PRESSURE"

Why is the fashion industry suffering?

The answer is rather simple: The current crises of the fashion industry stems primarily from increased margin pressure! However, the underlying reasons for it are multi-faceted.

Margin pressure resulting from retail growth

Although both sales growth and margin improvements, are important strategic factors in value creation, most companies have put retail sales expansion as top priority. Especially those companies listed on the stock market, which need to show an on-going success story to their shareholders, have expanded their operations at above-average pace. However, this massive and partly uncontrolled expansion led to the over-exposure of the brands in sales distribution and did not necessarily bring the expected reward. Most of the companies failed to adapt, their corporate structure and culture towards a market driven business. Moreover, with store-sizes growing larger and a declining square-meter performance at rising fixed costs, retail expansion has also become a significant spoilsport for many companies' margin development.

Margin pressure resulting from competition

The pressure on margin resulting from competition is threefold. Firstly, established companies are competing with some of the world's most rapidly growing fashion companies, among which there are vertical players like Zara and H&M. Their success is based on direct sales to consumers and a maximum of process efficiency in their business model. Secondly, increased competition occurs

from pure online players (e.g. Zalando, About You) entering the market, which added new market dynamics that have heavily affected consumer behaviour, contributing to the industry's overall declining price level. Thirdly, competition also derives from new, financially well-equipped market entrants from non-EU countries, that bring a merchandise over-supply in the market. All these factors affect the industry's price and margin level (e.g. Uniqlo, Under Amour). Changing consumer needs virtually force fashion companies to adapt their operations to 'glocalisation', which leads to further competition. Therefore, the fashion companies are challenged to exploit economies of scale through a viable global standard business model and a well-thought product range, while still responding to local consumers' needs.

Margin pressure resulting from a change in consumer behaviour

Resulting from ongoing digitalization, consumers' expectations towards a brand have significantly changed and so have the requirements that companies have to fulfil to meet those expectations. Instead of just getting the "right" product, at the "right" time, consumers want an entire and seamless shopping experience across devices, sales and communication channels.

To address this, we have divided the challenges that companies face into the six categories: communication, services, price expectations, product expectations, big data and sales channel integration.

1. Communication

With the rise of digital interaction, consumers are better informed than ever. Even taste and purchasing decisions are made online and often linked to social interactions. The easy accessibility and high reach of the internet has made it easy for influencers, such as bloggers or celebrities to reach a huge audience when 'predicting' taste and setting trends. This phenomenon not only affects price, product and service transparency, but also requires companies to establish strong and costly social media communication with their target group. Companies that missed the social media train are facing serious challenges in getting traffic to their sales channels and building their brand. Be it online or offline. Investing in those areas, however, is costly and drives margin pressure on the business model.

2. Service

With 'e-commerce pure players' entering the market and expanding rapidly, consumers have changed expectations towards brands-service portfolios. Thus, most e-commerce platforms attract customers by offering free of charge returns, 24/7 shop hours, various payment methods, a huge variety of stock and daily promotions. It is obvious that traditional retailers can hardly compete with e-commerce offerings and services provided. Furthermore, by having numerous (daily) promotions in place the online price levels off below industry standard, and naturally puts pressure on overall margin.

3. Price expectations

Vertical businesses like Primark, Zara or H&M offer the consumers products at an appropriate fashion level and an affordable price. Through this mass-fashion-market approach, the consumers' perception of the value of fashion has dropped significantly. Consequently, their price readiness is reduced to the same extent. In turn, brands are challenged to justify their price premium by either providing superior quality or emotionalising their brand.

> **"COMPANIES THAT MISSED THE SOCIAL MEDIA TRAIN ARE FACING SERIOUS CHALLENGES IN GETTING TRAFFIC TO THEIR SALES CHANNELS"**

> THE COMPANIES WHICH NEED RESTRUCTURING MOST SELDOM HAVE THE FINANCIAL MEANS AND CAPABILITIES REQUIRED TO GO THROUGH THAT PROCESS

4. Product expectations

While historically, good quality and/or a cheap price were key to the consumers' purchase decisions, today it has become more important providing products that match consumers' expectations towards a brand's positioning. For example, if brand communication talks consumers into thinking the brand is fashionable and affordable, the consumers' expectations are most probably satisfied if those attributes are equally reflected by the offering, even if the products are not of premium quality. The dilemma is, however, that numerous fashion businesses still claim that '*only the product has to be right to win customers*', whereas the mutual interdependence of brand positioning and product attributes is neglected. Therefore, businesses are recommended to determine strategies that lead to a consistent positioning in both, marketing and the product.

5. Big data

The key in marketing is to understand a company's target group. Not only have target groups shifted from traditional Western markets to the uprising middle class in emerging markets, but the consumers have also become more 'visible'. Digitalisation leads to huge amounts of data about the customer so that investments in business intelligence structures are required. The challenge is to filter relevant data, transform them into meaningful marketing strategies and derive a solid basis for entrepreneurial decisions.

6. Sales-channel integration

Consumers expect a seamless shopping experience. Therefore, the need for omni-channel functionality becomes increasingly vital to fashion businesses. Customer footfall in retail stores is suffering from lacking online fulfilment services, thus making it vital to reconsider the approach of retail within the entire sale- channel mix. Companies are challenged with the decision to consider retail as a means of achieving isolated commercial success or to play a supportive role across all sale-channels to maximize overall profits.

Moreover, most fashion SMEs, especially in Germany, still have a huge share of wholesale operations and lack online operations, making channel integration complex and dependent, as the wholesale partners control their sales-channels. The implementation of e-commerce requires know-how, technical infrastructure and aligned supply chains. Retail also puts margin pressure on wholesale operations, given that the two-staged margin model in wholesale leads to calculative higher (non-competitive) market prices, as compared to the vertical (single-stage) mark-up model of retailing or e-tailing.

The dilemma is that an alignment of wholesale prices to retail level combined with wholesalers' 'fixed' margin expectations would in turn squeeze the brands' wholesale margin, making the wholesale business more and more unprofitable (Gerry Weber, Esprit).

Corporate culture needs to be aligned as well. Companies are recommended to adopt an omni-channel mentality throughout the entire firm and achieve a consumer-centered 'thrust reverser' with their (new) business model.

Given the nature and history of all three sales channels, the challenge is to merge the young, flexible and fast dynamics of e-tailing, with the solid, inflexible and traditional principles of wholesale and retail operations. A challenge, that almost seems as difficult as balancing out "the for conflicting needs in every person, which go hand in hand with fear". For instance, being an individual versus being part of a group, or the need for constancy versus the need for change, according to depth-psychologist Riemann . In a broader sense, success lies in balancing the different needs and perspectives with all the individual contradictions and challenges.

Margin pressure resulting from sourcing

Increasing margin pressure deriving from the demand was historically compensated by 'simply' shifting to low cost sourcing regions. But, eventually, these areas became wealthier and purchase prices are rising. In addition, the consumers' consciousness about sustainable products increases. While 100% sustainability can seldom be achieved, getting there requires a costly permanent realignment of the entire value chain. Moreover, other macro-economic instabilities, such as the struggling Euro and recent events (in Turkey, for instance), will put even more pressure on margins and part of the industry at risk.

Who will be on the winning side? Or, according to the principles of Charles Darwin, which factors determine 'the survival of the fittest'?

There are appropriate solutions at hand to cope with the current and future challenges of the market. What can fashion companies do to be among tomorrow's winners?

The challenge goes far beyond just providing a good product. Nowadays the product itself is no more and no less than seen as an inevitable precondition for industry success, independent of whether it is based on superior quality or on meeting fashion trends. Delivering credible products seems to be most important, contributing to a consistent brand story. Companies need to emotionalize their brand perception in order to distinguish their (comparable) product on the market from other brands and thus to justify price premiums.

Consequently, a clear positioning, an appealing brand image, a consistent social media strategy and a well-integrated omni-channel strategy that is reflected by the corporate culture, are among the weapons for the must-win battles for tomorrow's winners. However, this requires substantial investments in infrastructure, know-how and technology. Unfortunately, many companies don't have a budget for this kind of strategy. The bigger the businesses are, the more resources they usually have available. Thus, the size of a firm is also a condition for success.

However, companies which neglect addressing the various modern issues of the fashion business (such as the need for brand building, sales-channel integration, social media communication, online marketing, big data management, digitalisation and supply chain efficiency) will most likely fail.

As e-commerce businesses are likely to grow, as foreign brands expand regionally and vertical businesses are gaining ground, mostly traditional retailers and SMEs are called to action. However, the crux of the matter is that those which need restructuring most, seldom have the financial means and required capabilities to go through that process. Those companies are strongly recommended to seek professional help.

The potential way out of the crisis

In today's fashion industry, markets and consumer expectations are complex, their development hard to anticipate, let alone calculable. Not responding to these expectations will most likely lead to direct failure.

Finally, as there is no such thing as a uniform solution to the fashion industry's success, a business is likely to succeed only if directly linked to its resources and showing a maximum capability of coping with the full set of industry requirements. This is what we call 'competenciation'.

Business are recommended to concentrate on core competencies and outsource those activities that would exceed their available resources.

Thus, 'competenciation' is based on the principle that a company naturally has to meet all market and consumer requirements in order to provide a viable and holistic market offering, but it still has to decide which demands the business can handle by using its internal capabilities and resources, and which activities should be outsourced.

In this way, the business model can still incorporate all requirements in the alignment of its value chain, while limiting the direct investments to what the company can do best. ■

Footnotes:

1. Riemann, F. (2009); Grundformen der Angst: Eine tiefenpsycholgische Studie

> **THERE IS NO SUCH THING AS A UNIFORM SOLUTION TO THE FASHION INDUSTRY'S SUCCESS**

Share your views!