Fashion Needs a Winner

One trailblazing new success would point the way for other designers and investors. BY EVAN CLARK

The economics of building a fashion empire have broken down. ¶ No longer can a young designer with vision and plenty of stick-to-itiveness get a favorable nod from a few key retailers and rave editorial reviews and parlay that into a business with bigger wholesale accounts, lucrative licenses for fragrances and handbags, flagships in major fashion capitals and a sustainable, multibillion-dollar growing empire. ¶ The biggies from fashion's last age – Giorgio, Ralph, Calvin, Tommy, Donna, et al – all took some version of that path to fashion superstardom. And their success was a beacon, a bright light followed by hordes of other designers, dreamers and, importantly, investors.

That Ralph Lauren or Giorgio Armani managed to become Ralph Lauren and Giorgio Armani and get rich doing it helped nearly everybody who aspired to great commercial heights in fashion. Designers pushing vastly different aesthetics could look to them or any of the other big names and plot their path ahead.

They could also sell others on that future.

It was – on the business side, at least – a matter of finding a few retail supporters, a little bit of free marketing love from a magazine and then explaining to any one of a number of investors looking to get into fashion how one was going to be the "next Ralph Lauren."

It was never easy to pull off, but it was an easy story to understand and get behind.

Now, not so much.

There are established successes in fashion, but no one who gives the impression of really killing it in the age of Amazon, social media and retail apathy. Plenty are trying and making headway – the likes of Alexander Wang, Proenza Schouler or Derek Lam and, at the more recent end, Cushnie et Ochs, Jonathan Simkhai, casual L.A. brand Rails or outdoor specialist Cotopaxi – but no one's made it far enough to sketch out a clear roadmap. And the companies that have garnered the most attention, like Warby Parker, Bonobos, Rent the Runway and Bauble Bar, aren't designer labels.

There are glimmers of hope, though. One contender in the accessories area is Kendra Scott, which recently sold a minority stake to private equity firm Berkshire Partners that reportedly valued the firm at around $1 billion. The Austin, Tex.-based brand is savvy online with more than 50 doors and a core base of strength in Texas and Oklahoma – far away from the fashion capitals.

But Scott is an outlier.

"There hasn't been a ton of validation around the new types of fashion companies," said Tracy Dubb, partner at M3 Ventures, which has investments in Cotopaxi, Rhone and others.

Dubb said investors are forced to "choose what the new way forward is going to be" and that there would eventually be companies that succeed on the strength of their marketing, or their supply chain or some other attribute.

"The truth is that they're just all going to look a little bit different than Michael Kors did," she said, noting the rush to invest in fashion brands after the company's 2011 initial public offering.

For now, the moneyed crowd is largely on the sidelines, waiting, looking for something that is, if not a sure thing, than at least a decent bet.

Fashion needs a winner to rally behind.

"Back in the day, it was a template that might have worked for a generation," said Jeffry Aronsson, who worked as chief executive officer of Oscar de la Renta, Marc Jacobs, Donna Karan and others and is now scouting for developing brands. "[Now] whatever the template might be might work for [only] that moment and that instant because of the speed of change and the convergence of new ideas, new technologies, new methods of selling."

Department stores used to be the lifeblood of the designer business. Not so much any longer.

"You know you're on a slippery slope and you get to the point where you can't live with [department stores] and you can't live without them," Aronsson said. "What's the new template? I think maybe that there is no new template. It demands creativity, it demands innovation, it demands focus and wise allocations of very limited resources, no matter how much they have."

While the path is not clear, there is something of a consensus about what the winners of the future will look like:

- They'll have good product.
- They'll have social-media savvy, be adept at telling their own stories to customers and able to convert followers into buyers.
- And they'll be quick to adapt and tight with their purse strings.

"My analysis of it is, the new model is magazines don't matter," said Gary Wassner, fashion financier and cofounder and chairman of InterLuxe, which has investments in Jason Wu and ALC. "What they have to say doesn't matter to Millennials." ▸

Illustration by AUTUMN WHITEHURST

He said the designer brands that are growing, such as Cushnie et Ochs (in which he has a personal stake), Alexander Wang and Jonathan Simkhai, are all good digital communicators.

And that's perhaps the most important new skill in fashion since the once-mediated conversation between brand and consumer has moved to Instagram and become unfiltered (or, in the case of the president-elect, Twitter).

"You have to have a very strong digital marketing concept," Wassner said. "It can't be fake. You have to dig deep into what your brand is about and you have to tell your story. We're not creating a marketing budget any longer for print. We're looking at really targeted marketing."

It's not just the fashion press – stores are also in large part losing their role as decider, of both what a brand is best at and what customers want.

"Institutions that have worked on a business model for so long, they never thought it would change and they never envisioned this kind of change," said Wassner, who is also head of Hildun, a factor that extends financing to brands selling to department stores that are now being threatened.

But with e-commerce still making up just 8.4 percent of total retail sales, according to government figures, digital is just part of the picture.

Investment banker Janki Lalani Gandhi, managing director at Lincoln International, said there are plenty of concepts rooted in the web, but that they still haven't proven they are lasting brands or clearly shown how click-and-bricks can best work together.

"I don't think it's clear what that combination is," Gandhi said. "We really do need omnichannel, but what's that mean? What's the right formula? I really do think that varies. Most concepts are so young they've only been around 10 years max, but in their current form, it's been three to five years."

The first wave of fashion-tech hybrids, including eyewear disruptor Warby Parker or fashion rental player Rent the Runway, drummed up a lot of attention and money on the tech side of the equation, but it's not clear that those companies are profitable yet.

Broadly speaking, the fashion-digital disconnect is that social media followers stay followers and don't become buyers. "On the beauty side, we're seeing winners left and right," Gandhi said. "That's really because...you truly have the conversion from social medial into actual dollar purchases. Apparel and accessories [companies] still need to figure out how to truly leverage digital advertising and marketing."

There is also a more vibrant wholesale base to play to in the hot beauty sector.

"Even if [as a fashion brand] you're selling through most Nordstrom doors, Anthropologie, Saks, Neiman [Marcus], you maybe get to a few hundred doors," Gandhi said.

The case is different in beauty, where vendors that break into Ulta's 949 stores and Sephora's 2,300 doors are linked into a thriving retail network that provides sizable distribution and a safe haven for their brands. That doesn't even account for department stores or, at the mass level, the thousands of drugstores.

Apparel enjoys no such refuge and the pressure, financial and otherwise, is on.

"There's this evolution that's been occurring for 20, 30 years, but the snapshot of today is, we're clearly in the early part of this changeover and I think Amazon in a weird way, not so much with high fashion, but with fashion and other consumer products, has really pushed people," said Joseph Lamastra, founding managing partner of Sandbridge Capital, which counts Thom Browne, Derek Lam and Rossignol among its investments.

"The winners of the future, whatever they are... the key is going to be strict expense control," Lamastra said. "What the online presence has done, it has eliminated any ability for you to have any fat in your company. If you're fat in your company, you're going to get killed. Someone will disrupt you. It's not the sexiest thing to talk about, but it's the reality. We are really on top of our cfo's [chief financial officers] to make sure that they're on top of their expenses."

Many fashion companies are extremely wary of doing business with Amazon and but still worry that, if the web giant wants their brand and can't get it directly, the sales dollars will instead go to a competitor.

"It's a little scary, they almost have too much power," Lamastra said. "It hasn't really reached the luxury level yet, but what if it's coming?"

That's the question that a lot of people have.

Amazon could be the great threat or the great opportunity, the secret weapon of the next big brand.

Bloomreach research found that 55 percent of online shoppers turn first to Amazon to search for products. In part, that's because the web giant has a vibrant marketplace, with its own fulfillment service that delivered more than two billion items last year.

Amazon's fashion business is mostly in basics now (an area it's building out with its own private-label offering). But higher-end fashion is clearly in the crosshairs. The company has tapped influencer Olivia Palermo to hawk fashion in online-only videos, it's sponsored fashion events in India, launched a streaming style show and more.

The desire is there, but hot brands are still playing coy, likely being cautious for good reason.

In the end, the path to the future might lead inevitably to or at least through Amazon. And the next big name might be not just socially slick and operationally efficient with compelling product, but also good at meeting consumers where they are – on Amazon. ■

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> **Joseph Lamastra**, Sandbridge Capital

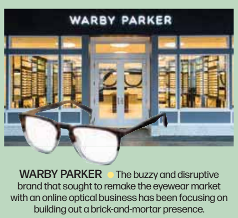
Businesses to Watch

While it's not certain to whom the future belongs, here are some brands and business models investors are watching.

RENT THE RUNWAY ● High fashion doesn't necessarily need to come with the high cost of ownership, according to this budding enterprise that rents out serious style. Merchants are intrigued by the model and Neiman Marcus just linked with Rent the Runway for a shop in its San Francisco store.

KENDRA SCOTT ● The Austin, Tex., accessories brand has built a base in Texas and Oklahoma and is gaining momentum. Berkshire Partners took a stake in the company, giving it a valuation that sources placed near $1 billion.

CUSHNIE ET OCHS ● The social media savvy of Carly Cushnie and Michelle Ochs helped the designer duo build a hot brand, which sold a stake to Farol Asset Management in 2015.



WARBY PARKER ● The buzzy and disruptive brand that sought to remake the eyewear market with an online optical business has been focusing on building out a brick-and-mortar presence.

BONOBOS ● Andy Dunn's men's wear business is doing a little bit of everything, with wholesale in Nordstrom, e-commerce on its own and guide shops that offer patrons a beer and ship their purchases to their homes.

Scott photograph by Ryan Kobane/BFA/REX/Shutterstock; Cushnie et Ochs by Joshua Scott; Bonobos store by Thomas Iannaccone

Where Will Macy's Lost Sales Go?

The department store is giving up $575 million in sales as it shuts stores, but picking that business up won't be easy.

By EVAN CLARK

BY THE NUMBERS

7%

The portion of Macy's 158,000 workers who will lose their job to a massive streamlining this spring.

24

square feet

The amount of shopping center space per capita in the U.S., compared with five square feet in the U.K. and four square feet in France, according to the International Council of Shopping Centers.

$4.99

The decline in Macy's stock during the first week of 2017, a 13.9 percent drop, to $30.82.

Where will it all go?

In an evolutionary fast-forward, Macy's Inc. is shuttering 63 doors this spring in a broader streamlining that will cut more than 10,000 employees from its payrolls.

The idea is to trim stores that are less profitable or have valuable real estate to become leaner and meaner, better able to compete against the off-pricers, Amazon, the e-commerce hordes and everyone else scraping for market share.

It's a move that nearly everyone, outside that 10,000, sees as necessary, if not overdue in an uber-competitive retail world where shoppers have access to more options than ever and are looking for better experiences when they do hit stores.

Lost in the mix of the closings: About $575 million in sales – enough revenue to make a venture capitalist cry for joy and fuel at least three tech start-ups to billion-dollar valuations.

The truth is, outright sales don't mean so much in retail today. Macy's logged sales of $26.1 billion in the last four quarters and has a market capitalization of just $9.4 billion. Better to have a smaller, hot brand that's got more potential to grow than a empire that needs to be turned into...what next?

While Macy's grapples with this, it's not like any one player is going to swoop in and grab that $575 million, which is distributed across the country, from Bangor, Maine, to San Diego.

Everyone who wants a piece is going to have to fight for it because fashion retailers are mostly selling want-to-have, not have-to-have items. And that's a big problem. People need to be motivated to spend.

"Any store in the market, whether it's a good store or not, has to work really hard with local marketing, local public relations and local events to drive traffic," said consultant Mortimer Singer, chief executive officer of Marvin Traub Associates. "The J.C. Penneys and Lord & Taylors in the vicinity, might be they get a small lift, potentially, but I wouldn't call it a meaningful one."

Macy's isn't just spending to drive traffic, but effectively spending to cut prices on goods to give shoppers that extra nudge once they're in the stores.

Singer said such promotions were "a huge driver." Retailers have to drive consumers to want to spend.

"Once that goes away [with store closings], if anything, you could argue that there's less competition in the market and it softens the competitive nature of the market," he said.

Some of the have-to-have purchases in that $575 million will go to other retailers. And the market share winners today will be different than they would have been 15 years ago.

"The biggest gainers have rotated from Wal-Mart, Target and Kohl's earlier, to the last 10 years, it's been T.J. [Maxx], most importantly and then Ross and then Burlington," said Craig Johnson, president of Customer Growth Partners.

E-commerce has also been a factor and e-commerce means Amazon, Johnson said.

"They probably should have been more aggressive in pruning in the years ever since the May acquisition," Johnson said, referring to the 2005 deal that brought May Co. and Federated Department Stores together and built the modern Macy's.

"They still have a great brand name," Johnson said. "It will be a much healthier, somewhat smaller company."

Still, more than half-a-billion dollars in business is being cast away. The question is: Can anyone else make something of it? ■

Illustration by SAM ISLAND