Think Tank: Fashion Disruptors Need to Think Like a Thoroughbred, Not a Unicorn

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By Arthur Zaczkiewicz on February 20, 2017

Fashion brands needs to change their mindset, and think like a thoroughbred.
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There's a better modus operandi for ensuring the success of direct-to-consumer brands and related fashion tech companies born digital.

Having strategically advised companies in this "new economy" and with a deep expertise in the traditional fashion industry, I'm proposing a new paradigm where smart "disruptors" strategically align with "disrupted" wholesalers/importers earlier in their business life cycles. These new disruptors will be better positioned for the long-term by being acquired by, or joint venturing with, more traditional strategic players sooner rather than later.

While this earlier entry model is not prevalent today, there’s a real opportunity here for both sides.

Fashion, apparel and related inventory intensive businesses are risky ventures that require a lot of capital and infrastructure to grow. That capital is often tied up for months in the form of in-process and finished goods inventory. The infrastructure requirements — primarily people and distribution capacity — and associated expenses increase the working capital needed to support future projections.

Any fashion-related start-up, whether a young ready-to-wear designer hoping to sell at Barneys New York or a digitally native brand, needs to launch with the appropriate levels of upfront and working capital to even have a chance at success.

For online businesses, these capital requirements are compounded by the cost of acquiring, engaging and analyzing customers, which makes them extremely difficult to scale profitably. These companies typically plan to burn through cash and seek venture capital money at high valuations so as not to overly dilute ownership in their ascent.

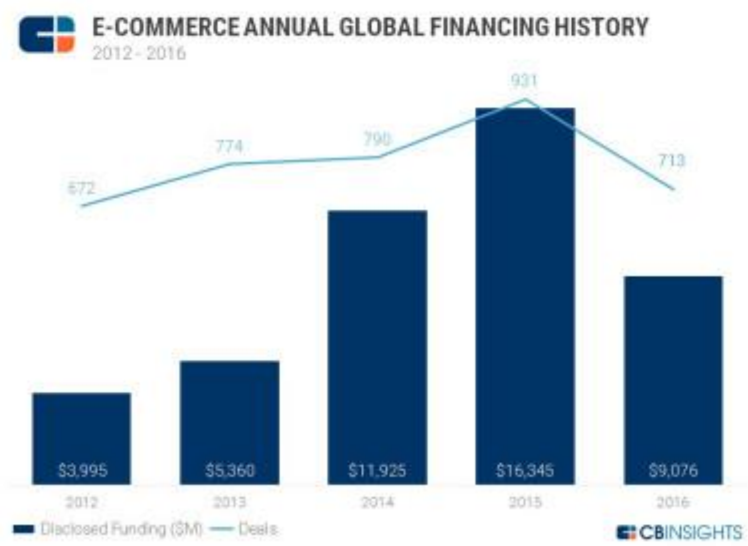
But many digital players are not proven infrastructure-builders nor product life cycle management specialists. Often, when the Series B or C rounds come in, they overspend on hiring and inventory without focusing nearly enough on profitability. When top-line growth slows they are forced to cut staff and heavily discount merchandise to stay solvent.

Gilt Groupe sold to Hudson’s Bay Co. for $20 million less than the capital it raised. Nasty Gal is in bankruptcy. These companies collectively raised over $300 million in hyper-growth mode, built large infrastructures and then hit a wall. Others have raised millions more and then disappeared altogether.

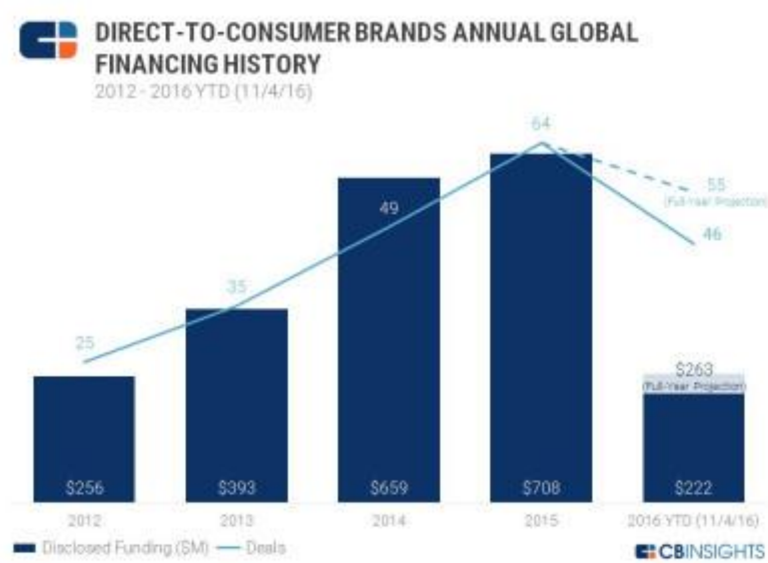
Fashion disruptors need to shift their mind-sets from “unicorn” to “thoroughbred,” concentrating more on permanence and profitability than cash burn and the chase of the billion-dollar valuation, exit or IPO. Thoroughbreds are resilient and agile, bred to triumph in the most challenging conditions to win race after race, while unicorns are simply creatures of mythology.

Venture capitalists like companies capable of exponential growth like Google, Facebook and Uber. None of these companies carry inventory, a huge impediment to exponential growth!

Those still investing in direct-to-consumer brands and related fashion tech companies are now focused as much on business fundamentals and a realistic path to sustainable profitability as they are on customer acquisition costs and lifetime value. This tightening of interest is well-illustrated by the below graphs. In 2016, total funding and the average investment size in both direct-to-consumer brands and e-commerce (Internet and mobile start-ups that sell physical goods, not including food or services) dramatically decreased, making it reasonable to assume that valuations will follow.



E-commerce financing. CB Insights



DTC financing. CB Insights

Private equity is gaining interest in the space and digitally native companies are seeking them out as an alternative to venture capital. This capital is often less strategic and extremely leveraged. Placing a huge debt burden on a younger company’s balance sheet is risky business. Historically, they invest for 3- to 5-year time horizons and, like venture capitalists, are beholden to making significant returns to their limited partners.

Traditional, “old-economy” wholesalers/importers of apparel and related goods (which may include private equity portfolio companies) are thoroughbreds sitting in the stable, for the most part, with big balance sheets and even more important, dynamic and leverage-able infrastructures. The best of these companies have built world-class, cross-functional teams that are operationally expert, specifically around product design and development, procurement and supply chain management. They are bottom-line driven, understand that profits are directly tied to managing selling, general and administrative expenses and inventory: 1) procuring finished goods at the right price and 2) turning full-price merchandise as quickly as possible.

For all their operating strengths, many old-economy companies are not as proficient as their digital counterparts at branding, marketing, and customer engagement. What's worse, many still view their customers as retailers not consumers and feel paralyzed to make the changes needed to survive. And even those taking steps to adjust to this is new-normal, would find it more cost-effective to acquire the digital know-how, customer lists and marketing talent rather than build it anew.

Technology has certainly democratized an industry once reliant upon big retailers to launch burgeoning brands. The barriers to market entry and potential success have been permanently lowered. It's hard to argue against the role that Macy's played in the success of a brand like Tommy Hilfiger and vice-versa, but those days are long gone.

Marrying the strengths of direct-to-consumer brands and related fashion tech companies to the strengths of old-economy companies early on is a win-win. The strategic benefits derived for each party far outweigh any alternative. Simply put, strategic alliances are built to last.

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