The Business of Fashion
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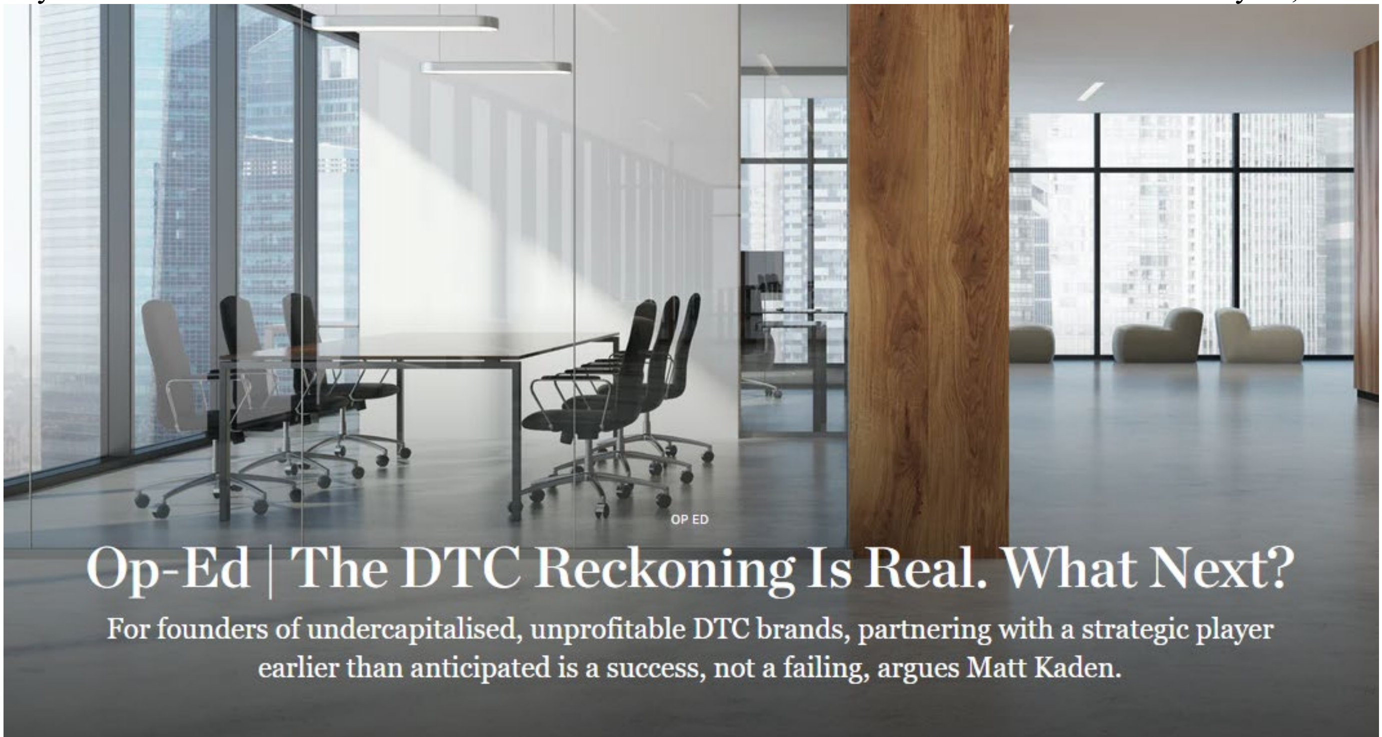

Boardroom | Source: Shutterstock

Prior to the Covid-19 outbreak, investors, lenders and prognosticators alike had spent a significant amount of time discussing the flaws in the funding model behind many direct-to-consumer fashion and apparel brands. They reasoned that most of these companies were maniacally focused on acquiring customers to grow revenue, but that they lacked any realistic path to profitability and, consequently, were greatly overvalued.

There's obviously a problem when we can count the number of profitable DTC fashion and apparel brands on two hands, they argued.

2020 was primed to be a year of reckoning for these digitally native brands, and many watchers expected to see a major correction to the DTC business playbook. But then the pandemic hit, depressing discretionary spending and moving almost all non-essential retail purchases online. E-commerce sales skyrocketed as most brick-and-mortar stores were forced to close for at least several weeks during lockdowns that spread across the country.

Those increased sales, however, don't change the fact that the model many DTC fashion and apparel brands rely on remains fundamentally broken. Increased online sales are neither proof of concept nor justification for unrealistic valuations for DTC brands, and no one should be convinced otherwise.

Bad Luck Isn’t the Same as a Bad Business Model

It’s easy to say that legacy retailers and brands whose business models rely heavily on their own fleet of stores or wholesale distribution were unprepared to deal with the current retail environment. But, of course, no company was prepared for the pandemic, and some businesses, through no fault of their own, were simply more exposed than others.

The virus outbreak is now taking a swift toll on both overlevered and marginal businesses with shaky fundamentals, accelerating bankruptcies that many viewed as inevitable months ago. But the pandemic’s effects on physical retail — and its potential collateral damage to raw material providers, manufacturers, vendors, commercial landlords and other services providers — is not the failure of legacy retailers as a group. They’ve suffered bad luck, which isn’t the same as a bad business model.

> ***“The model many DTC fashion and apparel brands rely on remains fundamentally broken.”***

Of course, an increase in online sales during an outbreak of a highly contagious respiratory virus that necessitates the closure of nearly all brick-and-mortar stores is no indication that a business model is good, either.

It’s important to remember that many digitally native brands rapidly expanded into physical retail, and even wholesale retail, in the name of omnichannel strategy. The problem was that, for many of those brands, the expansion was actually a tactic to acquire customers less expensively than they could be acquired online.

The luckiest companies right now are those DTC brands that had not yet expanded into physical retail when the virus hit— a decision that, for many, was more likely due to limited funding than to any strategic imperative.

Where Does This Leave Undercapitalised and Unprofitable DTC Brands?

A number of venture capital and private equity firms have lost their investing appetite for DTC fashion and apparel brands and are now targeting companies in more stable retail categories such as health and beauty and more relevant ones such as in-home fitness. That has left some DTC brands that are in need of funding staring at cram-down investments or expensive debt from their

existing capitalisation tables, options that only allow them to kick the can down the road in terms of solving the strategic and operational challenges that they will eventually have to face anyway.

What's the Solution for DTC Fashion and Apparel Brands?

What DTC fashion and apparel brands need to do now is chart a new course of action that will lead to sustained business success. Well-capitalised retailers, manufacturers and DTC holding companies present strategic partnership opportunities and a more realistic path to profitability for these brands. Founders and executive teams at DTC brands should not underestimate the know-how that leaders who have managed through past crises can provide, the scalability of established operating infrastructures or the force of robust balance sheets.

The few founders who still control the destiny of their own brand, even if they own only a small fraction of the company, should be willing to fight like hell right now to find a solution for achieving sustainable growth. If they exit to, or strategically partner with, a well-capitalised, experienced and stable company earlier than perhaps they initially envisioned, they should view it not as a failing, not as merely survival, but as a definitive success.

Matt Kaden is a Managing Director at MMG Advisors, a boutique investment bank.

The views expressed in Op-Ed pieces are those of the author and do not necessarily reflect the views of The Business of Fashion.