

THE 2015 CONSUMER VALUE CREATORS SERIES

# FASHION AND LUXURY

A NEW ERA OF OPPORTUNITY

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**O**VER THE PAST FIVE years, the global fashion and luxury sector has delivered extremely strong value creation, thanks to rising incomes in many emerging markets and a recovering global economy.

In 2015, The Boston Consulting Group conducted its annual study of the total shareholder return of nearly 2,000 publicly traded companies in 27 industry sectors, of which 41 were in the fashion and luxury sector.<sup>1</sup> (See *Value Creation for the Rest of Us*, BCG Value Creators report, July 2015.) During the five-year period from 2010 through 2014, the fashion and luxury companies in the sample returned an annualized TSR of 25%. The sector ranked first overall among the five consumer sectors we analyzed—consumer durables and retail (which tied for second), travel and tourism, and consumer nondurables were the other four—and first overall among all 27 industry sectors. (For an overview of the entire group of consumer sectors, see “The Return of Growth,” the BCG 2015 Consumer Value Creators Series, November 2015.)

## The Drivers of TSR

Most of the top-performing companies were able to create value primarily through sales growth and improved valuation multiples, with smaller contributions from improved margin performance. (See the exhibit, “The Fashion and Luxury Top Ten, 2010–2014.”) For example, Under Armour, which tied with Fawaz A. Al Hokair for first place, generated 29 percentage points of TSR from sales growth and 31 percentage points from changes to its multiple, with little or no contribution from any other levers. Under Armour is also notable in that it is one of four companies to make a repeat appearance on the top ten list, along with Sports Direct International (which finished third), L Brands (fourth), and Hugo Boss (fifth).

## Turbulence in China

As in prior years, the top performers in the sector were primarily mass-apparel companies, rather than high-fashion labels. That is partly due to flattening growth in emerging markets—particularly in China. During

## THE FASHION AND LUXURY TOP TEN, 2010–2014

				TSR Disaggregation <sup>1</sup>							
	Company	Location <sup>2</sup>	Average annual TSR (%)	Market value <sup>3</sup> (\$billions)	Sales growth (p.p.)	Margin change (p.p.)	Multiple change <sup>4</sup> (p.p.)	Dividend yield (p.p.)	Share change <sup>5</sup> (p.p.)	Net debt change (p.p.)	2015 TSR <sup>6</sup> (%)
1	Fawaz A. Al Hokair	Saudi Arabia	58.4	5.5	29	0	23	7	0	0	-24
2	Under Armour	United States	58.4	14.5	29	1	31	0	-1	-2	40
3	Sports Direct International	United Kingdom	48.7	6.6	15	11	15	0	-1	9	9
4	L Brands	United States	46.7	25.3	6	7	20	12	2	0	9
5	Hugo Boss	Germany	43.2	8.6	10	6	17	5	0	5	2
6	Foot Locker	United States	42.1	8	8	24	6	4	2	-2	28
7	Titan	India	40.9	5.4	22	2	17	1	0	0	-13
8	Signet Jewelers	Bermuda	38.3	10.5	11	7	21	1	1	-3	5
9	Hanesbrands	United States	36.5	11.2	7	8	11	1	-1	11	8
10	Ross Stores	United States	36	19.7	9	5	20	1	3	-2	6

Sources: S&P Capital IQ; annual reports; BCG analysis.

Note: n = 41 global companies with a market valuation greater than \$4.5 billion as of December 31, 2014.

<sup>1</sup>Contribution of each factor shown in percentage points of five-year average annual TSR. Any apparent differences in TSR totals are due to rounding.

<sup>2</sup>Location refers to the location of the company's corporate headquarters.

<sup>3</sup>As of December 31, 2014.

<sup>4</sup>Change in EBITDA multiple.

<sup>5</sup>Share change refers to the change in the number of shares outstanding, not to the change in share price.

<sup>6</sup>As of September 9, 2015.

the past decade, as that country's wealthier population increased in size and affluence, many fashion companies were able to grow significantly by opening new stores in the region. Yet when growth in China slowed and consumption rates eased in 2014, the revenues for those companies plateaued as well. Businesses are now trying to drive growth by improving same-store sales rather than opening new stores.

In addition, frugality and anticorruption reforms in China have hurt specific segments in the fashion and luxury industry. Gift-giving practices among private companies have slowed, and the custom of sending even small gifts to government officials or employees of state-owned enterprises for the Chinese New Year or the Midautumn Festival has largely vanished. What's more, the use of public funds for any purchase is now heavily scrutinized. This shift has directly affected the sales of luxury products—particularly watches, small leather goods, and business attire, all of which had been commonly purchased as gifts or perks.

We believe that, in the long term, the economic shift in China represents a necessary

correction rather than a more profound crash. The country still holds tremendous potential for fashion and luxury companies, provided that they can withstand some turbulence as the current correction unfolds. In the near term, one bright spot from the correction is that midlevel fashion and accessory brands—accessible luxury players, such as Coach and Michael Kors, along with “fast fashion” players, such as Zara and H&M—may benefit. The smaller indulgences that these companies offer are more moderately priced and thus more within reach of a wider segment of the Chinese population. In addition, a growing interest in health and wellness will lead to growth opportunities for sports and outdoor companies.

### Digital Opportunities

We believe that digital represents a foundational shift in the way fashion and luxury goods are sold, and that it will serve as a means to drive value creation for the foreseeable future in two ways. The first is through e-commerce. Digital sales represent a major opportunity, particularly for high-end fashion companies. In the past several years, many such companies have

resisted rolling out e-commerce sites on the grounds that buying goods online is not a true luxury experience. But increasingly, convenience is the *ultimate* luxury. The challenge is to create a differentiated experience for consumers.

One potential solution for many high-end fashion companies is to augment their online offerings with designer profiles, photo essays, videos, and other content that captures the rich heritage underlying their products. Another solution is to create differentiated offerings through exclusivity. Restricting access to confirmed customers—or those who are likely to make a high-end purchase—can change the way consumers experience a website or perceive a mobile offering. That said, finding the right balance between exclusivity and inaccessibility is tricky, and many companies will struggle to achieve it.

In addition, most high-end companies need to close the gap with mass retailers in terms of omnichannel execution. Increasingly, the ability to purchase, pick up, and return goods through any channel—whether online or off—is becoming a baseline requirement. Some fashion brands have taken steps to improve their omnichannel execution, but they must continue to build on that progress. More accessible luxury companies, such as Coach and Tory Burch, generate a much higher percentage of their sales through e-commerce than their competitors do and can serve as models for this approach.

The second opportunity offered by digital is the use of analytics and data to develop a more detailed picture of customers in order to better meet their future needs. We

expect that more high-fashion and luxury brands will use data and analytics to inform key decisions along the value chain. For example, in company-owned stores, customer data can be used to revamp assortment planning and merchandising on a regional basis. For online sales, companies can use data to tailor more relevant, personalized marketing offers.

Sports Direct International (third in our TSR ranking) is an example of a brick-and-click company that has managed to transform its business model and adopt a truly omnichannel approach. The company has grown by acquiring retailers and brands, such as Everlast and Slazenger, and by strengthening its own labels. But it also experienced a boost in online sales recently after introducing quick online check-out solutions, such as click-and-collect, as well as websites for its customers in European countries. Currently, Sports Direct is doubling the size of its warehouse in the UK in order to serve online customers more effectively.

**F**ASHION IS ALWAYS in flux, and markets expand and contract, but the basics of value creation do not change. Companies that can balance strong growth with attractive margins, employ digital, and meet their customers' needs will generate steady, reliable returns for their investors.

**NOTE**

1. TSR is a metric that encompasses all sources of value that accrue to shareholders. It includes changes in sales, margins, and valuation multiples, along with all sources of free cash flow to investors and debt holders, such as changes in dividends, net debt, and the number of shares outstanding.

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12/15