

Published: 5 January 2009

The Coming Fallout: Industry Weighs Which Sectors Will Survive

By Whitney Beckett and Marc Karimzadeh With contributions from Brenner Thomas, Karyn Monget and Caroline Tell, New York, and Luisa Zargani, Milan

Who will make the cut?

That is the question hanging over retailers, designers and manufacturers as the industry leaves a year it's desperate to forget and enters a new one that's likely to be even more challenging.

Consumer confidence that's lower than ever, a credit market that just won't unlock and a recession that is now truly global has executives wondering not just how much their businesses will shrink, but in some cases whether their companies will survive.

As a result, retailers are scrutinizing each line they carry more than ever, like lepidopterists focusing their magnifying glasses on butterflies. And that examination is only expected to increase as stores overcome the indigestion of one of the worst holiday seasons in decades and face a spring season that might not be much better.

So what are some of the most endangered species in fashion? Industry observers point to the following.

It all adds up to quite a list of businesses under threat, one that could expand if the economy doesn't start to see improvement in the second half.

But with stores bursting at the seams with too much inventory, steep and widespread markdowns and a virtual halt in spending, retailers are being forced to take action. Saks Fifth Avenue is reevaluating all its brands and categories to see which make sense in the current environment. After Neiman Marcus Inc. saw third-quarter earnings slump 84 percent in early December, its president and chief executive officer, Burt Tansky, warned that some "smaller and marginal vendors" are being dropped. Barneys New York and Bergdorf Goodman are said to be taking a serious look at all their categories and brands, too.

Ron Frasc, president and chief merchandising officer of Saks, recently explained to analysts: "We must make the hard decisions on a brand-by-brand basis. Those brands that are nice to have can't exist in the new environment. Each brand must lend both financial and strategic [value] to the company."

Already Saks has revealed plans to shutter 16 of its 18 bridal salons — affecting bridal lines including Amsale, Carolina Herrera, Reem Acra, Monique Lhuillier and Oscar de la Renta — to make room for higher-growth categories.

In separate conversations, Frasci told WWD that brands with a strong consumer resonance, such as Cartier, Graff and Chopard, will weather the financial storm. Jim Gold, president and ceo of Bergdorf Goodman, pointed to collections such as Chanel, Bottega Veneta and Nancy Gonzalez. Brands at high price points lacking a connection with consumers are more vulnerable.

There is also a consensus that, going forward, retailers only will do business with those who can do business with them: in other words, those that have the resources to help with markdowns and returns and generally share the pain of consumer penury. Consequently, after markdown negotiations are completed for last season, fewer firms may make it onto retailers' vendor lists. Analysts and consultants predict retailers will be presenting their vendors with an ultimatum: Pay up for last season's record-high markdowns, or don't expect to sell here again.

“There's going to be a line drawn in the sand, and with it, significant fallout,” said Andrew Jassin, managing director of the Jassin-O'Rourke Group LLC fashion consultancy.

Some vendors won't have the money to pay and stay in business, and others might decide that the cost of doing business at a particular retailer is simply too high.

As retailers squeeze out vendors, many of them could move to take greater control of their own destiny by opening more of their own stores or by focusing less on U.S. department and specialty stores and more on international markets such as the Far East, South America and the Middle East, a trend that already has been seen in the last few seasons.

Cristiana Cavalli, president of Roberto Cavalli SpA, said, for example, that the company is opening more of its own stores in the U.S. this year, with one slated for Las Vegas after a Dallas unit opened last year. “For 2009, we expect our performance to be constant, in line with 2008, while we believe in the growth of our accessories division, in which we have lately been investing.”

Franco Pené, chairman of Gibò, which produces collections for Michael Kors and John Galliano, among others, and controls the Jil Sander brand, believes companies will be much more affected this year than in 2008, despite the general “steep vertical drop” in the last three months of last year.

Pené underscored the psychological component, which heavily weighs on consumers. “The surrounding uncertainty has a devastating effect,” he said. Generally speaking, he said, “a heavy drop in orders does not reflect a real drop in consumer spending.”

“The real problems will come with the fall-winter 2009 season,” he pointed out, adding that he's already seen a heavy “deterioration of payments in the supply chain.”

Linda LoRe, president and ceo of Frederick's of Hollywood, said it's imperative that designers offer edited assortments “that will grab the attention of consumers.”

“So offerings now are not so broad,” she said. “That's why [retailers] are looking at this the way they are. They want inventory that is manageable. At Frederick's, we also brought a focus on key items. In private label, you might say there are these items that will do 40 percent of our business. It's very much the same thing at Saks, which would say, ‘Do I need to carry all of these brands? Can I get the same results from 10 rather than 15 brands, and is this classification still valid?’”

One ceo of a major American men's lifestyle brand, who requested anonymity, compared the merchandise shakeout with the credit market. “We've been chasing luxury for years. Stores have been trading up, reaching for that luxury dollar, and now we have a deleveraging period,” he said. “People are trading down. Michelle Obama was celebrated for wearing J. Crew. We're going to purge 20 years of excess.”

He challenged the view held by some retailers that luxury consumers are just waiting to buy again, arguing that consumers fundamentally have changed. “The Zegna guy isn't the Zegna guy anymore. When this economy rebounds, luxury will not have the same pull it used to have. We're talking about a shift in the way people approach apparel.”

But the ceo agreed that certain categories might be hammered. He pointed to traditional, conservative brands as particularly vulnerable. “The fashion guy will buy because he wants to, but the more classic consumer isn't shopping.” The executive also said branch stores will be most severely hit by cuts to the assortment. “Those doors don't have the clientele to support a diverse array. Expect major consolidation there.”

As the market focuses more and more on the mantra of “only the strong survive,” one of the areas likely to be hardest hit is young and emerging designers. “Many of their businesses were small, and already somewhat challenged in a good economy,” said Robert Burke, founder of consulting firm Robert Burke Associates.

While Burke declined to name specific designers, he said, “The independent designers that are self-funded right now, with businesses less than \$4 million or \$5 million, are especially vulnerable, and there are many of them.”

Footwear at a contemporary price point “still has validity,” added Burke. However, he and other observers cautioned that handbags could become more difficult because the category overall has risen in price over the past few seasons.

“Handbags are going to suffer more than jewelry or shoes — that space is too oversaturated,” said Suzanne Hader, principal of luxury consulting firm 400Twin. “And within the categories, brands that have tied themselves heavily to trends will fare less well. Customers equate those types of brands with looks that ‘expire’ after a season. So from a consumer perspective, Bottega Veneta and Chanel will be considered safe picks.”

Elsewhere in accessories, Burke said fashion and costume jewelry should do well, “but high-end jewelry exists for a small percentage of wealthy people who see it as an investment at this point.”

Which is perhaps why some of these firms are nervous about the year ahead. “I’m worried about 2009,” Henri Barguirdjian, president of Graff in the U.S., told WWD last week. “We deal with the superhigh end, and more regular clients, if you will, making \$200,000, \$300,000, \$500,000 a year who are not spending money because they have been tremendously affected by the economy. The first quarter of 2009 will be tremendously challenging for everybody.”

Jeffrey Aronsson, the co-founder of Aronsson Group, said niche fashion brands — high-priced designer labels with limited distribution — generally will face a tough time. “I don’t know if stores will stop buying them, but I wonder if they will buy as much,” Aronsson said. “A lot of these brands offer statement pieces, and I don’t know if people who can afford them will be in the mood to buy them.”

Arnold Aronson, managing director of retail strategies at Kurt Salmon Associates, said, “Consumer spending in the luxe segment has changed dramatically.

“Even Barack Obama said the other day there’s going to be more pain until there will be relief,” said Aronson. “To me, this is going to last awhile. Stores, whether Macy’s or Kohl’s, will have to plan lower levels. The question is, do you cut 10 percent off of every style of every vendor you have? This is not a democratic process. There are going to be winners and there are going to be losers based on their track record. Retailers will have to separate the dead wood from the live wood,” he said.

David Wolfe, a creative director at The Doneger Group, observed that “superprestige brands” will survive the economic turmoil because stores don’t typically expect them to have high volume. Celebrity brands, in contrast, might be even more endangered than they’ve been over the last few seasons. “I think the celebrity brands will be looked at very carefully,” Wolfe said. “Their main purpose is to get people into doors, and you don’t need huge numbers of inventory to do that.”

In terms of price, both the top and bottom of the spectrum are at risk.

“The moderate zone is completely under siege, even more so now because the product is devalued by the dramatic sales in the higher zones,” Jassin said. “Plus, the moderate zone has the least margin, and department stores need higher margins to put goods on sale.”

On top of that, retailers might cut vendors that they simply don’t think are viable in a tougher economy. Consultant Emanuel Weintraub said retailers will use three criteria in determining which vendors to keep on this year: Does the vendor produce product that sells, does the vendor deliver on time and will the vendor still be in business to fill its orders?

“This is a downsizing industry and merchants at retailers buying goods are personally vulnerable,” Weintraub said. “Just like credit lenders, retailers want zero risk. In the past, we didn't worry that we'd give a large order and midseason a vendor would go out of business. So they need to know their vendors have strong balance sheets and access to credit, and that they are willing to take back merchandise if the retailer cancels orders. Many vendors are trying to unload the canceled goods at Marshalls, but those whom it would bankrupt aren't allowing retailers to cancel orders without paying — and retailers want to avoid that risk.”

Weintraub estimated that about a quarter of non-public manufacturers will find themselves with inadequate financing in this economy and are at risk of being cut by retailers.

In the end, how valuable a vendor is to a retailer still comes down to one main concept: product. “It all goes back to the same exact comment it always goes back to: The people who will make it out of this standing are the ones who really know their customers and what their customers want,” said Erin Armendinger, managing director of the Jay Baker Retailing Initiative at the Wharton School of the University of Pennsylvania. “When people's wallets are slapped shut, you have to give them a really strong reason to open them.”

Regardless of how many vendors retailers cut from their lists, they certainly will have to cut deliveries from most, if not all, of the retailers that remain, sources agreed.

“This may be the first year retailers will take racks off their floors in 20 years,” said John Henderson, a director at Net Worth Solutions Inc., who for years worked at Kellwood Co. “They need to rein the amount of product in to match the level of customer demand, rather than the traditional floor plan.”