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Mergers and Acquisition in the Fashion Industry

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Abstract: On August 10th, 2023, Tapestry Inc., the parent company of renowned fashion brand Coach, announced a definitive agreement to acquire Capri Holdings Limited, which owns the iconic brands Michael Kors, Versace, and Jimmy Choo. This move signals the company's aspirations to establish a powerful global portfolio of ironic luxury brands, one that would rival European conglomerates LVMH, Richemont, and Kering. Merger and Acquisition is a strategic tool utilized by organizations worldwide to adapt to the demands of today's dynamic business environment. This strategy has gained significant attention and prominence in the fashion industry. Therefore, this study employs profitability metrics, liquidity metrics, and credit metrics to assess the post-merger financial performance of a select group of fashion companies, thereby gauging the effectiveness of the M&A tool. Results of this study show that there are no significant improvements in financial performance following the merger and acquisition.

Keywords: Fashion Industry, merger and acquisition, financial performance, profitability

1. Introduction

In the 1980s, the European luxury and fashion industry underwent an organizational transformation shifting from small & medium-sized family businesses to large groups, seeking centralized control over financial resources, distribution systems, and a diverse brand portfolio [1]. Today, the three conglomerates hold a dominant position in the luxury industry. Consequently, the three luxury houses' business practices such as strategies and organizational structures have been models for smaller companies in the fashion industry to emulate and apply [2].

The announcement by Tapestry Inc. regarding the agreement with Capri Holdings Limited that it would acquire Capri Holdings Limited to establish a powerful global house of fashion brands grabbed my attention to this particular topic. In recent years, the leading luxury retailer Coach has adopted several strategies to rebuild its brand images image, including reducing coupons and discounts. It also acquired Kate Spade and Stuart Weitzman, and then it changed its name to Tapestry, reflecting that many brands sit under its umbrella. For Tapestry Inc., this acquisition is another strategic move towards establishing a larger global luxury house that would compete in the fashion industry. Research has shown that the fashion industry is one of the least impacted areas in times of economic recessions [3]. According to Bain & Company, following a sharp contraction in 2020, the global luxury market has rebounded and surpassed its pre-pandemic sales levels in 2021 and 2022. LVMH, the world's largest luxury group reported robust sales growth in fiscal years 2021 and 2022 despite the impact of Covid-19 lockdown policies in China and economic volatility resulting from the war in

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Ukraine. Despite the market volume and growth potential, the fashion industry is characterized by its highly cyclical nature and serious idiosyncratic risk [4]. Previous research mainly focused on identifying key value drivers in fashion M&A deals, but few analyzed the operating performance after M&A.

The objective of this paper is to analyze the post-merger financial performance of a select group of fashion companies and to assess the efficiency of the M&A tool. My approach in this paper is to use post-merger accounting data to test for changes in operating performance.

2. Literature review

A significant number of mergers and acquisitions (M&A) transactions have occurred since the turn of the 20th century, substantially restructuring industries across various regions of the world [5]. Since the early 1990s, a growing proportion of M&A transactions have adopted the cross-border acquisition format [5]. In the industrialized countries, a total of 19,996 M&A transactions worth $1390 billion took place between 1990 and 1995, followed by 34,147 M&A transactions valued at $8135 billion between 1996 and 2001[6]. According to the Institute for Mergers, Acquisitions, and Alliances, more than 790,000 M&A transactions have been announced worldwide with a known value of over $57 trillion.

M&As are a useful tool to improve both acquirers' and target companies' competencies, organizations, and performance [5]. Previous studies have examined how target companies benefit from the directions and interventions of the acquirers, and how the value of involving firms might be enhanced. In Goold et al. [6] paper, researchers proposed parenting advantage, which is parent companies create value for the subsidiaries and influence the decisions and strategies of the subsidiaries. For acquirers, M&As are channels through which can improve efficiency and create value. M&As are processes that exploit economies of scale and scope, optimize capacity utilization, and realize synergy. Other motivations for M&As are to lower transaction costs through the acquisition of cost-saving technologies and spread fixed costs over a larger base. Furthermore, M&As might bolster product market power by allowing merging parties to cross-sell products to a broader customer base [5-8].

Few researches concentrated on M&A transactions in the luxury industry. In the paper by Meinshausen & Schiereck[4], 192 bidder transactions at a total value of $25,480 million were selected to analyze the value implications of M&As in the fashion industry and to determine the market dynamics of this particular sector. The criteria applied by Meinshausen & Schiereck[4] are the following: 1) both acquires and targets operate in the fashion and accessories industry; 2) the bidders are publicly listed and the trading data pre- and post-acquisition is available; 3) the transactions are finalized; 4) the transactions endow the acquirer more than 50% of voting rights. In Meinshausen & Schiereck's [4] research paper, they find that positive abnormal returns are distributed to acquiring shareholders. Contrary to the expectations, they further reveal that large companies as frequent acquirers do not witness significant shareholder wealth increases. In Kapferer& Tabatoni's [9] research paper, they analyze the LVMH–Bulgari deal which was announced in 2011 from interrelated marketing and financial–strategic perspectives and reveal why the family-owned companies would abandon their persistent "family-owned" policy and merge with luxury powerhouse. For the previous family-owned companies such as Bulgari, the first reason for them to sell up is the dilemma of the transmission of their companies. As their heirs/heiresses are not willing to manage the companies, and other family members who hold shares may have friction with talents hired outside. The second reason is the leadership and undercapitalized financial problems to accelerate expansions. This is a win-win opportunity. For LVMH, its watches and jewelry division had a weak performance and it seek to close the gap with Cartier and Tiffany (who was acquired by LVMH in 2021). The family-owned business gains cash as well as the skills in brand development, expertise, synergies, talents,

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and institutional support. Kapferer& Tabatoni[9] further stated that only the most successful powerhouses such as LVMH, Kering, Richemont, etc. can generate enough cash flow to finance their massive investments while others may have more difficulties.

Findings from previous research conclude that M&As do impact firms, but they do not give a definite conclusion on whether M&As would increase a firm's financial performance.

3. Methods

According to Giacosa's [10] book, the following are the main types of acquisition in the luxury industry:

Table 1: Typologies of Acquisitions

Types	Definitions	Examples
Vertical acquisitions	The acquiring companies acquire one of its suppliers or key customers	LVMH purchased Les Tanneries Roux, a supplier that manufactures high-quality leather
Horizontal acquisitions	The acquiring companies and the target companies operate in the same business sectors and manufacture the same/similar products	In 2006, Prade acquired 100% of Church
Concentric acquisitions	The line of products manufactured by target companies is in the same category as the acquiring companies, and the technologies in the supply chain are similar	LVMH acquired Fendi, Emilio Pucci and Acqua di Parma. PPR acquired Brioni, Gucci and Bottega Veneta
Conglomerate acquisitions	The acquiring companies and the target companies were not related, and they formed by combining different business units.	Richemont, whose core business is jewelry and watches purchased the American clothing brand, Peter Millar.

Followed by the methods used in the article of Abbas et al [11], accounting and financial methods are employed in this study. The following indicators are used to analyze acquisition activities.

Table 2: Indicators used to analyze acquisition activities

Variable	Indicators
Profitability & Efficiency	Return on Equity (ROE) = Net profit after tax / Total equity
	Return on Assets (ROA) = Net profit after tax / Total Assets
	Net Margin = Net Income / Total Revenue
	Earnings Per Share (EPS) = Net profit after tax / No. of ordinary shares
	Interest expense to Interest Income = Interest expense / Interest Income
Liquidity	Total Liabilities to total assets = Total Liabilities / Total assets
Leverage	Debt to Equity Ratio = Total Debt / Total Equity
	Capital Ratio = Total Equity / Total Assets

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4. Case Study – Richemont

The core business of Richemont Group is jewelry and watches. The main businesses are divided into 3 parts: jewelry maisons – currently consisting of Cartier, Van Cleef & Arpels, and Buccellati, specialist watchmakers – such as IWC, Piaget, and Jaeger-LeCoultre, and other brands formed by fashion and accessories brands.

From 2013, Richemont did not involve as many horizontal acquisition activities as LVMH and Kering. It maintains its three divisions in a steady state, with only a few brands being sold and acquired. In 2017, it sold Shanghai Tang, a Chinese chic brand. In 2018, it sold Lancel, a French luxury leather goods company. Richemont acquired full ownership of YOOX NET-A-PORTER GROUP (YNAP), the world's leading online luxury and fashion retailer in the same year. In 2019, Richemont extended its fine jewelry expertise by acquiring Buccellati. In 2021, Richemont acquired Delvaux, a renowned luxury leather goods company. In 2022, Richemont announced an agreement with FARFETCH and Alabbar to turn YNAP into a neutral industry-wide platform, thus giving up YNAP's controlling stake.

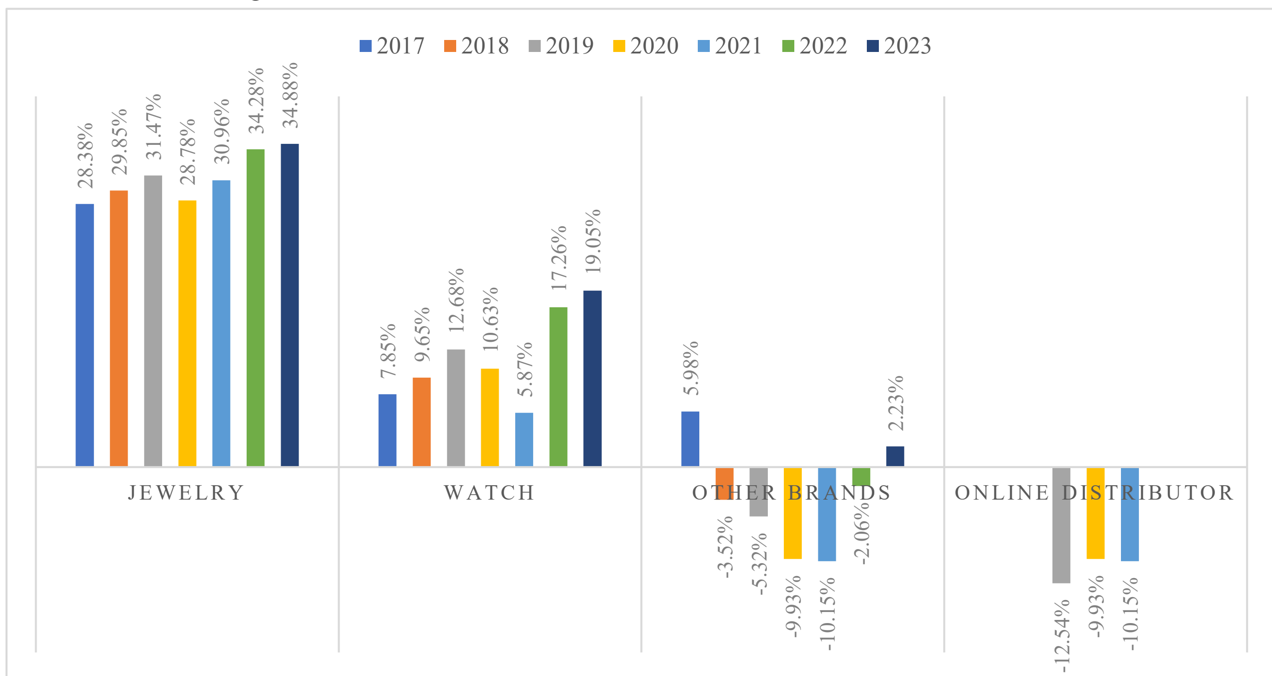

Figure1: Richemont operating margin [12].

In Table 2, Richemont jewelry and watch divisions maintain a stable high operating margin except for the years under the impact of COVID-19. However, the other brands division which includes fashion and accessories brands witnessed a consistent negative operating margin for years.

Table 3: Richemont Profitability & Efficiency Ratio [13].

Fiscal Year	2017	2018	2019	2020	2021	2022	2023
ROA	6.01	5.34	10.39	3.19	3.95	5.51	0.77
ROE	7.91	8.1	17.63	5.47	7.45	11.04	1.61
Net Margin	11.36	11.12	19.9	6.55	9.9	10.81	1.57
Diluted EPS	2.141	2.158	4.927	1.646	2.296	3.611	0.543
Interest Expense to Interest Income	86.30%	94.20%	154.08%	177.78%	259.04%	212.15%	138.36%

In 2019, the ROA, ROE, net margin, and diluted EPS ratios reached a high peak and decreased in the following year due to the impact of COVID-19. In the flowing year of 2021 and 2022, the performance rebounded to the pre-COVID-19 state. However, in 2023, the ratios dramatically decreased as Richemont discontinued its operations in YNAP. Interest expense to interest income represents the cost efficiency. From 2019, Richemont could not minimize the interest expense and non-interest expense, signing them and failing to enhance cost efficiency.

Table 4: Richemont Liquidity Ratio [12].

	2017	2018	2019	2020	2021	2022	2023
Total Liabilities to total assets	22.97%	42.73%	39.23%	43.34%	49.42%	50.33%	53.48%

In Table 4, from 2018 – 2021, more than 40% of assets were financed by liabilities. The total liabilities/total assets ratios increased to over 50% in 2022 and 2023, which could mean that this ratio has not improved after the acquisition of the online distributor and other fashion brands. Richemont increasingly depends on liabilities to generate assets. In Table 5, Richemont is carrying a relatively low leverage.

Table 5: Richemont Leverage Ratio [12].

	2017	2018	2019	2020	2021	2022	2023
Debt to equity	13.59%	55.77%	63.80%	48.70%	57.42%	55.95%	53.91%
capital ratio	77.03%	57.27%	39.23%	43.34%	49.42%	50.33%	53.48%

Table 6: Comparison with Kering [12].

Fiscal Year	2017	2018	2019	2020	2021	2022
ROA	18.83	41.72	25.57	19.14	30.71	29.37
ROE	30.22	29.59	21.20	25.36	18.63	19.34
Net margin	11.54	27.19	14.53	16.42	18.00	17.76
Debt to equity	0.36	0.32	0.65	0.60	0.49	0.58

Table 7: Comparison with LVMH [12].

Fiscal Year	2017	2018	2019	2020	2021	2022
ROA	8.00	8.90	8.40	4.58	10.29	10.84
ROE	18.57	20.78	20.82	12.71	28.48	27.55
Net margin	12.03	13.57	13.36	10.53	18.74	17.79
Debt to equity	0.24	0.19	0.42	0.66	0.51	0.42

Table 6 & Table 7 are part of the comparison of the ratios with LVMH and Kering. Compared to the two luxury powerhouses, Richemont has a relatively low ROA, ROE, and net margin. At the same time, the equity-debt-to-equity ratio of the three companies does not have much difference.

5. Conclusion

The study analyzes Richemont's operating performance from 2017 to 2022. I find no significant positive enhancement in operating efficiency for Richemont after the mergers and acquisitions. It is hard to predict an ideal post-acquisition size for the company. From the statistics and ratios, Richemont did not achieve huge success after the acquisition of some fashion and accessories brands. It increased its ownership in YNAP, expecting a boost in growth in the digital luxury platform. However, its discontinued operations in YNAP represent its failure in this acquisition. In the luxury and fashion industry, M&As are highly practiced but do not guarantee a prominent operating performance. For other smaller companies in the fashion industry who want to start their global expansion or establish diverse brand portfolios, they may face years of negative cash flow as the profits generated cannot finance the massive investment.

This paper only targets valuing financial performance after the acquisition. M&A deals in the fashion and luxury industry are often used as a means through which companies can achieve or maintain economization. Through mergers and acquisitions, fashion companies can aim to optimize the management of individual brands by sharing various resources such as human resources and knowledge sharing. Further research could exploit how the impact of COVID-19 and the economic recession change fashion companies' strategies regarding M&A deals and what kinds of target companies would fashion industry would be interested in.

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