SECTION D100

Strategic Analysis for: Abercrombie & Fitch Co.

Sindhu Krishnan

Kevin Lowe

Adrian Siy-Yap

Anqi Wang

Kelsey Williams

Date of Submission: November 18th 2013

Synopsis

FIRM HISTORY

Abercrombie & Fitch Co. (A&F) began as a Manhattan-based retailer of exotic sporting goods in 1892. The company was originally named "Abercrombie Co." after its first founder, David T. Abercrombie. Abercrombie was a former railroad surveyor and miner who also owned a small factory in lower Manhattan that manufactured camping equipment. The company's other founder was Ezra H. Fitch, a renowned lawyer in New York and one of Abercrombie's biggest clients. In 1904, Fitch bought a majority interest in Abercrombie Co. and the company was officially renamed Abercrombie & Fitch Co. Unfortunately, the partnership between Abercrombie and Fitch did not last as both men had conflicting ideas on how to run the small waterfront shop (Abercrombie & Fitch Co. History, n.d.). In 1907, Abercrombie sold his shares to Fitch and focused on operating his other business.

Fitch kept the name of the company and sought out new business partners. In 1917, Abercrombie & Fitch Co. relocated to a 12-story building on Madison Avenue. By this time, the company had many famous clients, including Charles Lindbergh, Ernest Hemingway, and Theodore Roosevelt. In 1928, Fitch retired and sold his shares to his brother-in-law, James S. Cobb, who became the president of the company. Abercrombie & Fitch Co. added new lines of sporting goods for recreational activities such as skating, polo, golf, and tennis as well as outdoor clothing and footwear for both men and women. In the 1940s and 1950s, net profits rose as more stores were added in downtown areas of large cities and resort areas across the United States. However, the company began experiencing lower profits over the 1960s. After losing $1 million in 1975, the company declared bankruptcy and closed its doors in November 1977 (Abercrombie & Fitch Co. History, n.d.). Many believe that the continued losses were caused by management's stubbornness to reduce prices and its inability to transition its merchandise to reflect the trends of the 1970s.

The brand was revived by Oshman's Sporting Goods who opened a store under the Abercrombie & Fitch name in Beverly Hills, California in 1979. The subsequent new chain of Abercrombie & Fitch stores concentrated on more modern sporting goods and grew to 26 stores by 1986. In 1988, the brand was sold to The Limited, Inc. for $45 million in cash and the corporate headquarters was moved to Columbus, Ohio. The president at the time was Sally Frame-Kasaks who repositioned the company as a casual apparel retailer with mid-priced merchandise that were labeled with the Abercrombie & Fitch logo (Abercrombie & Fitch Co. History, n.d.). Michael Jeffries, current president of Abercrombie & Fitch Co., was brought in after Frame-Kasaks left the company. Jeffries saw potential in the American teen retail market and focused the company's products on preppy, fashionable clothing at a high-price point. The company also began a magazine called *A & F Quarterly* which acted as a catalogue for Abercrombie & Fitch's merchandise and also featured articles that targeted the teen demographic. In February 1999, Abercrombie & Fitch Co. once again became an independent company as The Limited, Inc. divested the company from its business portfolio.

CURRENT INDUSTRY ENVIRONMENT

The retail discretionary space is a cyclical, fragmented and highly competitive industry. With low barriers to entry and limited functional differentiation features across apparel brands, there is extensive emphasis on marketing and brand perception. Key issues and trends in the industry include economic volatility, globalization, government intervention and non-traditional channels.

The industry remains competitive amidst uncertainty on the global economic and geopolitical landscapes. While retail brands have performed better than the overall market, with continued unemployment and slowing economic growth across the globe, companies potentially face increased pressure on apparel demand just ahead of the critical holiday shopping season. Global apparel companies face increased risks related to international operations with extreme volatility in foreign exchange markets, especially the Japanese yen (Bloomberg, 2013).

While emerging markets are experiencing slower economic growth, the emergence of the middle class in these markets increases the attractiveness of foreign development. The percentage of emerging countries' populations living on less than $2 per day has fallen to 41% in 2010 from 65% in 1990 (PricewaterhouseCoopers, 2013). Companies seeking to capitalize on foreign opportunities are met with challenges set forth by governments, including local sourcing requirements, tariffs and restrictions on foreign direct investment.

With rapid advances in technology over the past decade, there is increased emphasis on full integration across physical and digital channels to remain competitive. Direct-to-consumer sales metrics take the spotlight as sales through traditional channels remain challenged. Multichannel shopping has enabled companies to expand margins and tap into new and emerging markets including China, the leader in use of Internet sales channels (PricewaterhouseCoopers, 2013). Widespread adoption of online shopping and social interaction has also facilitated the collection of consumer data to support formulation of product branding strategies. Companies, now with enhanced information on consumer behaviour and preferences, are able to better personalize products to target demographic markets.

Amidst challenging economic conditions, consumers are becoming increasingly price-aware. Some companies have ventured into new demographic markets in attempt to cater to multiple price points (Deloitte, 2013). Companies seeking to penetrate new pricing markets are met with challenges of brand preservation or enhancement and those entering lower-end consumer markets face increased pressure on profit margins.

CURRENT SITUATION

Abercrombie & Fitch was once considered one of the preppiest, coolest, most desired and successful teenage clothing brands in the early 2000s. However, in today's market, Abercrombie & Fitch's performance and image is declining fast. Abercrombie & Fitch reported a 9% decrease in revenue and a 17% drop in same store sales in the first quarter of 2013 (Thrasher, 2013). In addition, there was a 43% earnings miss versus analyst profit estimates that sent shares down nearly $10—more than a 20% decrease—in late August 2013 (Forbes, 2013). Over 18 million shares were traded that day, which is more than nine times the 90-day average of 1.9 million.

These lower than expected results are occurring due to the poor performance of the segments catering to women's and teens' fashion needs as well as overall reduced traffic volume domestically and internationally (Forbes, 2013). Abercrombie forecasted that it would lose money in the next quarter, partially because sales are down internationally. Sales are down 26% internationally from last year and Abercrombie has already experienced a significant amount of backtracking in its international expansion due to the slowed growth rate overseas (Lutz, 2013).

Furthermore, in November 2013, Abercrombie & Fitch Co. announced that it will be closing down all 28 of its Gilly Hicks branded stores. Gilly Hicks is an Australian-themed women's underwear line that was recently launched in January 2008. Unfortunately, the brand was unable to generate significant sales resulting in a $30 million annual loss (Piper Jaffray & Co., 2013). Abercrombie & Fitch Co. will continue to offer select Gilly Hicks branded apparel online and through its Hollister stores.

Abercrombie & Fitch Co. has also been in public relations issues that may be partially responsible for the company's current financial troubles. In 2006, A&F's CEO, Mike Jeffries, stated that brand will not be carrying extra large or XXL sizes for women in their stores due to the fact plus-sized women are not considered to be a part of the "cool" teen image the company is trying to market to (Thrasher, 2013). In addition, they have also experienced multiple lawsuits related to their strict employee policy regarding looks and style resulting in discriminatory practices.

Whether it is A&F’s PR practices, its clothes and store experience, or its marketing strategies and brand image that is affecting the company’s performance, something must be done in order to help revitalize this brand and maintain profitability.

CURRENT STRATEGY

Business Level Strategy: Focused Differentiation

Abercrombie & Fitch Co. operates three casual apparel lifestyle brands: Abercrombie & Fitch, abercrombie kids and Hollister. Abercrombie & Fitch Co. further differentiates itself through its e-commerce platform. This allows customers to shop online in addition to A&F branded stores. All three brands are differentiated by embodying the values and aspirations of a specific group or culture through its marketing.

<u>Abercrombie & Fitch and abercrombie kids</u> – Both brands are based on the lifestyle of privileged East Coast American students that attend prestigious preparatory schools or Ivy League universities. Retail outlets support this brand image through a luxurious store environment and core products which are priced approximately 30% higher than competitors (Credit Suisse, 2012). Abercrombie & Fitch targets 18 to 22 year olds while abercrombie kids targets the 7 to 14 year old consumer segment.

<u>Hollister</u> – The Hollister brand targets the 14 to 18 year old teen segment. The brand represents the laid-back Southern California lifestyle with an emphasis on surfing and having a good time at the beach. Consistent with this image, Hollister stores are designed as vintage surf shops and products are priced approximately 10-15% below the average competitor (Credit Suisse, 2012).

Corporate Level Strategy: Moderate Diversification and Market Development

As A&F generates more than 30% of its sales revenue outside a single business unit, the company has a moderate level of diversification. In 2012, 53% of revenues were generated by the Hollister brand, 39% by the Abercrombie & Fitch brand, and 8% by abercrombie kids (A&F Annual Report, 2012). Furthermore, all three business units or brands are related constrained as they share product, technological and distribution links.

A&F is also pursuing a market development strategy. The company has prioritized international expansion with a focus on China and Japan (A&F Analyst Day Presentation, 2013). In 2014, A&F aims to open four to six new stores in China and three to five new stores in Japan (A&F Analyst Day Presentation, 2013). A&F is also planning to enter the Middle East in 2013 (A&F Analyst Day Presentation, 2013). In Europe, A&F intends to slow expansion with limited new store openings (A&F Analyst Day Presentation, 2013).

International Strategy – Global

A&F uses a global international strategy to achieve standardization across all markets. Standardization includes not only A&F apparel but also extends to the design of company stores. This high level of standardization provides authenticity to the lifestyle that A&F's brands attempt to embody.

Cooperative Strategy – Franchising and Complementary Alliances

As part of A&F's market development strategy, the company intends to pursue franchising opportunities to enter large, complex markets such as Brazil, Russia and Mexico (A&F Analyst Day Presentation, 2013). Furthermore, A&F is engaged in vertical and horizontal complementary alliances. The company utilizes private label products designed by its suppliers as a means to quickly supplement its assortment of products (A&F Analyst Day Presentation, 2013). Also, A&F has recently collaborated with Keds to provide exclusive styles of Ked's popular sneakers under the Hollister brand (Piper Jaffray & Co., 2013).

STRATEGIC CHALLLENGES

During the past two years, Abercrombie & Fitch Co. has experienced negative growth in both domestic and international markets. The company closed 71 stores in the United States during 2012 and plans to close another 40 to 50 stores in 2013 as a result of weak performance. In a recent conference call, A&F CEO Mike Jeffries stated that a further 180 stores in the US will be shut down by 2015 (Ghigliotty, 2013). In attempt to offset slow growth in its domestic market, A&F has expanded overseas operations. However, the performance of international stores has been just as disappointing. International same-store sales in 2012 decreased by 26% compared to 2011 (Lutz, 2013). Also, Q3 2013 international same-store sales growth is down 15% (Ghigliotty, 2013). For A&F to return to positive growth, the following strategic challenges must be properly addressed.

The Rise of "Fast Fashion" Competitors

In recent years, "fast fashion" retailers such as Zara and H&M have been able to capture significant market share. In particular, Zara has been able to consistently grow revenues during the past several years. In 2012, the Spanish retailer recorded revenues of 7,239 million Euros, up from 6,209 million Euros in 2011 (Waters, 2012). In the first half of 2013, the company's sales rose another 6% compared to the previous year (Geoghegan, 2013). Experts believe that one of the biggest reasons for Zara's success is the company's commitment to the fast fashion concept. By controlling its own supply chain, Zara is able to introduce new products faster and cheaper. This allows Zara to be at the forefront of fashion trends and be the first to introduce new trendy styles. In contrast, A&F's products have remained largely stagnant with its consistent neo-preppy design philosophy. The classic preppy look defines A&F, but it limits the company's ability to cater to changing consumer preference. A&F needs to address the threat of fast fashion retailers or face the risk of further market share erosion.

Repairing A&F Brand Image from Recent Public Relations Missteps

Abercrombie & Fitch Co. has been heavily criticized for refusing to carry larger clothing sizes and publicly telling reality stars to stop wearing their brands. While A&F may have made these comments for publicity, the incidents clearly portray the company's strategy to maintain an exclusive image by targeting a narrow demographic. In attempt to defend this strategy, CEO Mike Jeffries has stated that "...companies that are in trouble are trying to target everybody: young, old, fat, and skinny. But then you become totally vanilla. You don't alienate anybody, but you don't excite anybody, either" (Cantor, 2013). Although maintaining an exclusive brand image is how the company successfully differentiates against competitors like American Eagle and H&M, these recent tactics may have been detrimental to the company. A&F is not wrong to target a specific demographic; however, it could improve on the methods of delivering that message to avoid the alienation of potential customers.

Capitalizing on the Online Shopping Trend

With 24/7 availability and avoidance of travel time, the convenience of purchasing online has been a primary factor behind the online shopping trend. Online shopping also offers a wider range of choices by providing access to pure play online retailers and overseas retailers. Consumers are able to easily compare prices across retailers and take advantage of daily deals, group purchasing sites and flash sales to source lower priced merchandise. The online shopping movement has been facilitated by a number of experience enhancing services including fast shipping times, in-store returns for online purchases, customization of products, and tailored product suggestions based on past purchasing patterns.

In 2008, A&F launched the company's Direct-To-Consumer (DTC) business segment allowing customers to purchase A&F products online. The DTC business currently generates over $700 million in annual sales (34% CAGR) and ships to over 120 countries. A&F's existing value-added DTC features include in-store returns for online purchases, "find-in-store" capabilities and "mobile scan-and-buy" services. The company is looking to further enhance its DTC service through "order-in-store" and "ship-from-store" strategies. A&F faces the challenge of expanding its DTC business, a primary driver of future growth, in a competitive environment where user site experience, shipping and customer support standards are driven by established pure play online retailers.

Balancing Competitive Pricing and a Premium Brand Position

Abercrombie & Fitch Co. has faced an internal ongoing debate regarding the use of price promotion to generate store sales. This issue has become prominent in recent years due to the downturn in the global economy. Competitors such as H&M have relied heavily on discounts to gain market share while A&F has struggled with its premium brand position and pricing. In the past, A&F has rejected the use of discounts to promote its products as it would diminish the brand image. As a result, the company experienced a 68% drop in earnings in Q4 2008 (Smith, 2011). Further losses followed in 2009 and 2010. In response to shareholder pressure, Jeffries unwillingly implemented price promotions across its brands that were based on domestic customer spending patterns. However, the slow adaptation of price promotions has positioned the company behind its competitors. Regardless, the company has chosen to continue using different pricing methods in an attempt to recapture some of the lost market share from previous years.

REFERENCES

Abercrombie & Fitch Co. (2013, February 22). *Q4 2012 Abercrombie & Fitch Co. Earnings Conference Call*. Retrieved from http://www.abercrombie.ca/anf/investors/investorrelations.html

Abercrombie & Fitch Co. (2013, March 22). 2012 *Annual Report*. Retrieved from http://www.abercrombie.ca/anf/investors/investorrelations.html

Abercrombie & Fitch Co. (2013, November 6). *Abercrombie & Fitch Analyst Day Presentation*. Retrieved from http://www.abercrombie.ca/anf/investors/investorrelations.html

Abercrombie & Fitch Co. History. (n.d.). Retrieved from http://www.fundinguniverse.com/company-histories/abercrombie-fitch-co-history/

Bloomberg L.P. (2013). *Depreciating local currencies pressure branded apparel sales*. Retrieved from Bloomberg database.

Cantor, B. (2013, May). Abercrombie & Fitch’s "mistake" - Is it about customer management or political correctness. *Customer Management IQ*. Retrieved from http://www.customermanagementiq.com

Credit Suisse (2012, October). *Too early to call turnaround, promotional environment adds near-term pressure. Initiate underperform with a $32 TP*. Retrieved from Capital IQ.

Deloitte. (2013). *2013 outlook on consumer products*. Retrieved from http://www.deloitte.com

Fleming, O. (2013, November 6). Abercrombie & fitch ditches 'cheeky cousin' Gilly Hicks after lingerie and sleepwear brand battles declining revenues. *The Daily Mail UK*. Retrieved from http://www.dailymail.co.uk

Geoghegan, J. (2013, September). Zara-owner Inditex's profit rises as sales grow 6%. *Drapers*. Retrieved from: http://www.drapersonline.com

Ghigliotty, D. (2013, February). Abercrombie & Fitch to close up to 50 stores in the U.S. following weak sales during the holiday season. *The Daily Mail UK*. Retrieved from: http://www.dailymail.co.uk

Lutz, A. (2013, February). Abercrombie is in trouble. *Business Insider*. Retrieved from http://www.businessinsider.com

Piper Jaffray & Co. (2013, November). *Confidence shaken; strategies appear appropriate but will take time; OW*. Retrieved from Capital IQ.

PricewaterhouseCoopers. (2013, September). *Retail and consumer trendwatch: The shifting sands of going global*. Retrieved from http://www.pwc.com/en_GX/gx/retail-consumer/publications/assets/pwc-r-and-c-trendwatch-the-shifting-sands-of-going-global.pdf

PricewaterhouseCoopers. (2013, February). *Retail and consumer worlds express: The great leap online*. Retrieved from http://www.pwc.com/en_GX/gx/retail-consumer/pdf/pwc-randc-worlds-express-the-great-leap-online.pdf

Smith, J. (2011, July). Abercrombie & Fitch: To price promote or not to price promote. *Wiglaf Journal*. Retrieved from http://www.wiglafjournal.com

Thrasher, M. (2013, July). How Consumers Fell In And Out Of Love With Abercrombie & Fitch. *Business Insider*. Retrieved from http://www.businessinsider.com

Waters, C. (2012, September). *The five keys to Zara's money-making and whopping 17% sales growth*. Retrieved from http://www.smartcompany.com.au/growth/economy/28092-the-five-keys-to-zara-s-money-making-and-whopping-17-sales-growth.html

Woo, S. (2012, February). Online-Retail Spending at $200 Billion Annually and Growing. *The Wall Street Journal*. Retrieved from http://blogs.wsj.com

Zacks.com. (2013, August). Abercrombie dressed to disappoint. *Forbes*. Retrieved from http://www.forbes.com