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# The Economics of Fashion: Do Newcomers to the Industry Have a Chance?

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# Do Newcomers to the Industry Have a Chance?

by

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# ABSTRACT

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New York, Paris, London, and Milan have long established themselves as fashion capitals of the world. These cities have become cluster economies with numerous connections, resources, and buyers close at hand. For this reason, firms often establish themselves in these cities to take full advantage of cluster economies and increase their chances of survival. Thus, a large number of leading international fashion firms reside in these cities. This thesis uses the finances and international market presence of these fashion companies as benchmark values for what it means for another company to be "successful" at becoming a major player in the industry. By doing a comparative analysis of the growth and profitability of companies based in one of the current fashion capitals and companies based in emerging fashion industries, it was found that a new company does not need the perceived benefits of cluster economies to become a leading firm in the global fashion industry. Companies in the emerging fashion industries of Sweden, Canada, Japan, Germany, and Portland, Oregon have become world-renowned fashion brands in their respective locations. This conclusion gives further insight into whether any new cities or countries have a chance at becoming another major global fashion hub. Since individual firms have been so successful, an "infant" fashion industry should be able to overcome the established advantages in current fashion capitals and become a major player in the global industry with strong growth and operational strategies at the firm and industry-level.

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# CHAPTER ONE

# INTRODUCTION

## A. Historical Background

The fashion industry as it currently stands had its beginnings in Italy in the 11th Century, growing to a height during the Renaissance. The fashion industry began to decline in Italy in the 17th Century, about the same time when it was burgeoning in Paris. Mass production of fashion for the public began in Paris in the 1670s. As for England and the U.S., textile production began in the 1700s and 1800s, respectively, as the proper technology became available. This allowed for the middle and lower classes to have access to ready to wear fashion. By the early 20th Century, couture houses, like Chanel and Balenciaga, were eventually established in Paris, marking the beginning of the luxury fashion industry (Phillips 2014).

Nearing the mid-20th Century, World War II caused many couture houses in Paris to close. Unaffected by the war, New York became the new location for uniform production. The different style and emphasis on more athletic uniforms established New York as a contender in the global fashion industry. The shutdowns of World War II also led to New York holding the first ever Fashion Week, called "Press Week" at the time, for American fashion designers to show off their designs to those people who could not go to Paris due to war. Once the war had ended, Paris fashion houses were back in action, focusing on their couture, while Florence, Italy, also became a hotspot for Italian couture. London, on the other hand, focused on more casual, everyday fashion, while still keeping itself distinct with edgy and different styles. Since there was a much larger market for this casual wear, designers in Paris and Milan eventually began producing "pret-a-porter," or ready-to-wear, fashion to keep up with New York and London.

This put Milan on the map as a fashion capital, rather than Florence, and began Milan Fashion Week. Paris Fashion Week also began in 1973, and London Fashion Week began in 1984, the last two of the four major fashion weeks. With this rich history of fashion, these four cities became known as the four major fashion capitals of the world (Phillips 2014).

### B. Core Thesis Question

The bigger picture question for this thesis is, "can an "infant" fashion industry overcome the established advantages in current fashion capitals and become a major player in the global industry?" This larger scale question will be addressed at the firm-level by determining if fashion companies not based in one of the four major fashion capitals can compare to those companies that are based in a fashion capital, in terms of profitability and financial success. The initial hypothesis is that due to external economies of scale and cluster economies, the current fashion capitals should have certain advantages and resources that enable those companies located in the cities to have more success in the global industry. However, with the increase of globalization and outsourcing of production, there may be less of a need to depend on these few "fashion capitals" to build a leading firm in the global industry. This would suggest then that a new fashion empire could be established in a new city or country.

### C. Definition of Fashion

Since the term fashion is very broad and can have various meanings in different contexts, it is important to know what exactly is meant by fashion in this thesis. Most importantly, this thesis focuses on the clothing fashion industry. While there are many well-known fashion accessory, shoes, and jewelry brands, the companies chosen for this study are mainly producers and sellers of clothing. This is not to say that the companies have not developed lines in

handbags, shoes, or leather accessories, for example, but the focus of these companies is still developing, showcasing, and selling their clothing lines.

Clothing is also a very broad area of fashion. There is, for example, designer clothing, couture, fast fashion, casual wear, retail, athletic wear, outerwear, and even traditional clothing. Thus this thesis attempts to account for the different types of clothing in the market by including and comparing multiple categories of clothing companies. While all types of clothing production and sale could not be included in the analysis, three major categories included in this thesis are luxury and designer fashion, fast fashion, and athletic or sportswear.

### D. Purpose

The conclusions of this thesis could prove useful for designers and entrepreneurs looking to start new fashion companies. Depending on the success of the companies looked at in this study, an up-and-coming designer would know whether or not they should establish headquarters in a fashion capital or another city. This thesis divides the fashion companies into categories based on the type of fashion that a company specializes in. This allows for new designers to also make more informed decisions on location, based on the type of fashion company they wish to create. This thesis will be the first to include a discussion of the global fashion industry, rather than focusing on one sector of it. So while the conclusions of this thesis are more reliable for the countries and cities specific to the companies included in the study (those being cities in Sweden, Germany, Canada, Spain, and Japan), ideally, the conclusions of this thesis should be indicative of the success prospects for new fashion companies in any new location across the world. The conclusions of the empirical analysis give business prospects and propose success strategies for designers in other emerging fashion cities to build successful empires.

## E. Thesis Structure

Following this chapter, this thesis will contain four other Chapters. Chapters Two-Four contain the majority of the work of the thesis. Chapter Two includes an explanation of the economic model that is being tested in the thesis, as well as a review of the previous literature related to this topic. Chapter Three develops the analytical framework used in this thesis and explains the data collection and manipulation process. Included in this are justifications for data and fashion companies that were selected for the analysis. Chapter Four interprets the results of the data, drawing conclusions on the successes of different fashion firms. Finally, Chapter Five summarizes and concludes the findings of this thesis, as well as giving recommendations for future research on this subject.

# CHAPTER TWO

# LITERATURE REVIEW

In order to understand the status of the global fashion industry, an overview of the existing literature on the state of individual fashion industries is needed. The fashion industries in New York, Paris, Milan, and London are often topics of discussion, however emerging fashion industries in Canada, Ghana, Uganda, Sweden, and Los Angeles are now being studied. The following pieces of relevant literature all contribute specifically to the core question of this thesis and provide further insight. Mainly, they address: have emerging fashion industries been successful in the global market and what factors have led to success or failure? While there is much literature published relating to the global fashion industry as a whole, the literature referenced in this thesis specifically pertains to this topic of the successes and failures of emerging fashion industries in the global market. Before outlining the relevant existing literature, however, this chapter will begin with an explanation of the theoretical model behind the inner-workings of the fashion industry. This theoretical knowledge is imperative to understand the relevant literature and eventual analysis of results in this thesis.

## A. Theoretical Background

The economic theory that is exemplified by the fashion industry is economies of scale, more specifically, external economies of scale. Economies of scale is the phenomenon that occurs when a producer experiences increasing returns to scale. Increasing returns to scale is when the cost per unit decreases as more are produced. This type of advantage to production can happen at the firm level or the industry level, hence there are two types of economies of scale: internal and external. With internal economies of scale, as the size of an individual company

increases, so does its productivity, thus this is at the firm level. External economies of scale is at the industry level, so as the size of a whole industry increases, productivity does as well. When an industry exhibits external economies of scale, many businesses of the same nature establish themselves in the same area. This is why external economies lead to cluster economies, regions characterized by clusters of companies of the same type of business (Krugman et al. 2015). Clusters can form in entire regions, towns, or cities. Historically, fashion companies, whether they be for design, manufacturing, retail, publications, or all of these, tend to congregate in cities like New York, Paris, Milan, and London to ensure success. Thus, the fashion industry exhibits external economies of scale and is a prime example of a cluster economy.

There are three main determinants of external economies of scale that lead to a particular industry forming a cluster economy (Krugman et al. 2015). If an industry exhibits labor market pooling, knowledge spillovers, and specialized suppliers, then this it is more beneficial for this industry to cluster and grow in one small area, which is the defining characteristic of external economies of scale. Labor market pooling is important for an industry when there is the need for a very specialized group of labor in terms of skill and industry knowledge. People who possess these skills enter the market for labor in these clusters, creating a large "pool" of possible employees. Labor market pooling is beneficial for producers since this distinct type of labor is easily accessible and replaceable, and it is beneficial for the workers because they are searching for job opportunities in an area where their skills are desired. Knowledge spillovers occur when the research and knowledge of one company spreads to other companies and allows everyone to advance. In cluster economies, since companies are in such close proximity, this happens often whether or not it is intentional. This happens intentionally by studying the products and methods of other companies, or unintentionally when workers meet outside of work and exchange their

work stories. When there are multiples companies of the same type clustered together and in need of certain equipment, services, or products that either are uncommon or required in a short amount of time (or both), this creates a large enough market for suppliers of these specialized goods to serve. This is what causes many specialized suppliers to also establish themselves in these industry clusters, as it benefits them and it benefits the industry (Krugman et al. 2015). If there had been just one industry in the area in need of specialized goods, there would not a large enough market to necessarily sustain a specialized supplier, so clustering is crucial to support these specialized suppliers.

An economy can only specialize and exhibit external economies of scale for a certain industry if there is some initial advantage to establishing that industry in that area. This can either be through a comparative advantage, which occurs when one region has better resources and technology for production of a certain good, or through an established advantage (Krugman et al. 2015). An established advantage is often the result of historical accident, also known as path dependence. In this scenario, all that matters for establishing an advantage is "who got there first." There is no logical reason that a particular industry would form in that country or region, but simply because they were the first to establish that industry and take over world demand for that particular good, the region has gained the established advantage in production of that good. Just as with comparative advantage, it is hard for another country or region to overcome an established advantage without outside financial support, even if that specific industry has the potential to be more efficient (lower production costs) in that other region (Krugman et al. 2015).

### B. Fashion Industry as an External Economy

The global fashion industry has clearly formed in clusters that exhibit external economies of scale. Clusters of the global industry have formed in New York, London, Paris, and Milan,

and are forming in other cities as well. The individual fashion industries in these areas benefit from the three determinants of external economies. Many designers and stylists, as well as editors and models, all choose to live and work in major fashion hubs. This type of labor, which is essential for fashion companies to continue designing, releasing, and advertising new lines each season, is pooled in these centers and easy for employers to find. When new trends are being developed or becoming popular, designs and marketing tactics spread between different fashion companies and become industry-wide knowledge. Designers often need to make prototypes of their designs to show fashion executives or potential buyers, which requires specific fabrics and patterns for which there are specialized suppliers in these fashion hubs. Magazine publications are specialized suppliers of publicity for fashion companies, while on the other hand, fashion companies supply these publications with content.

In addition, the four aforementioned fashion hubs had no comparative advantage over other cities when it came to fashion production. Rather, it was historical accident that led to a few fashion companies starting up in these cities and becoming popular. From their success, more and more companies decided to also establish themselves in these cities, eventually forming clusters. Now these cities are home of the most well-known fashion brands and host bi-annual fashion weeks, both of which perpetuate their status as fashion capitals. Companies that are starting up believe it to be advantageous to establish themselves in these cities that have better resources and opportunities. Emerging economies in new countries and cities may have a very difficult time gaining their own status in the fashion world without outside support.

### C. Other External Economies

While the structure and development of the global fashion industry has made it a prime example of a cluster economy, there are many other notable examples of cluster economies.

These include, the Hollywood and Bollywood movie industries in Los Angeles and Mumbai, the auto industry in Detroit, the Financial District in London, and the IT industry in Silicon Valley. An analysis similar to the one in this thesis can also be conducted on these industries to see the effectiveness of external economies of scale.

While there is a native film industry in almost all countries around the world, the largest output comes from Hollywood and Bollywood. In the early days of filmmaking, many directors and producers chose Los Angeles, California due to its extended period of dry, warm weather (Medel and Gossel 2015). As time went on, many major studios established their headquarters in the city and a cluster began to form. Now, many aspiring actors, directors, and film employees choose to relocate to Hollywood in search of job opportunities. There is a huge clustering of talent and opportunity in this Los Angeles neighborhood. Similar to that, Bollywood film production is centered in the Indian city of Bombay (or Mumbai) and those interested in joining the industry travel to the city for open auditions. It is very clear why the film industry exhibits external economies of scale. Specialized labor of acting, directing, designing and filming, as well as quick access to sets and costumes is crucial to the industry's success (Medel and Gossel 2015).

While most people associate New York City as being the global financial capital, London also has had a financial district comparable to New York's Wall Street, referred to as the "City," established long before Wall Street was. Many major financial institutions have established headquarters in London, including Bank of England, HSBC, Barclays, and Lloyds Banking Group. The London Stock Exchange also has a market capitalization of almost $4 trillion. This financial cluster provides investment and commercial banking activities, as well as foreign exchange and bond trading services. The clustering of financial institutions has proven to be very

successful as London accounts for about 36.5% of daily turnover in the global foreign exchange market and 46% of daily revenue in the global interest-rate derivative market (UNCSBRP 2019).

Detroit, Michigan has become what is known as The Motor City. While the automobile industry has had much success in Detroit due to the Great Lakes shipping industries and a large workforce, the industry was founded here simply because many entrepreneurs decided to make Detroit their home (Counts et al. 1999). By 1924, three of America's largest automobile manufacturers established headquarters in Detroit: General Motors, Ford, and Chrysler. Thus, Detroit's economy has depended greatly on the state of the global auto-industry. In the beginning, the city flourished as American cars were popular with consumers. However the globalization of the car industry has had tremendous impacts on Detroit's success. There have been many declines of the automobile cluster in Detroit over the years as import sales increased with competition from Japanese and European compact cars, multiple oil crises occurred, and companies were forced to adhere to certain pollution and safety guidelines. Many production plants are now being moved to Mexico to reduce costs and make American car companies comparable to their foreign counterparts. Thus, the automobile industry of Detroit is on a steep decline that can only be revived by allowing any American or foreign car companies to set up headquarters in the area (Counts et al. 1999).

The IT industry of Silicon Valley is arguably one of these most successful cluster economies. Silicon Valley was not always the center of the tech world however, and it took over decades for it to become how it is today. The area was "chosen" based on its proximity to the Stanford University campus, because many of the original entrepreneurs in the area were Stanford graduates who were encouraged by the Dean of engineering at the time, Frederick Terman, to start their own companies (ICANN 2011). While the area began with radio and

military technology, it has evolved to become a production and innovation center for semiconductors, computers, and more recently software. Currently, Silicon Valley is the home of Apple, Google, Cisco, and Hewlett-Packard, among other large tech companies. In conjunction with the clustering of technology firms, many venture capital firms and law firms have established themselves in the area (ICANN 2011). Thus the tech companies in the cluster make use of the labor pooling of technologically adept people, the knowledge spillovers from new hardware and software research, and the specialized suppliers of technology parts, legal services, and venture capital.

### D. Current Fashion Capitals

There is little dispute over the fact that New York, Paris, London, and Milan are international fashion capitals, with their respective countries holding sizeable shares of the top 100% of global fashion sales (these shares being 21%, 23%, 3% and 17% in 2013, respectively) (Cusinato et al. 2017). Thus, the existing literature on this topic does not question the success of these fashion centers, rather it looks at developments and industry culture at the firm-level in these cities. Related to the question of whether or not fashion industries can successfully be established in new cities or countries, is a new company's decision to establish itself in an existing fashion center or another location. Even though a design firm may choose to establish itself in New York City, for example, this does not guarantee that it will reach the level of participating in New York Fashion Week. Many fashion designers participate in Fashion Week in order to show their entrance, continued presence, or exit from the luxury fashion market, and many of the designs showcased are then sold in boutiques, flagship stores, or department stores (Katagiri 2016). However, Fashion Week is an exclusive event, limited to a certain number of luxury designers. If too many designers were to participate in New York Fashion Week, then this

weakens the value of "high-end" goods and also hinders the financial successes of established luxury designers. This all plays a role in a firm's decision to enter the luxury fashion market. Katagiri (2016) found that higher per capita disposable income and larger population results in a higher number of designers able to be supported in the New York Fashion Week shows and luxury fashion market, so these are important factors for startup fashion companies to keep in mind. Regardless, making it into the Fashion Week shows of one of these major capitals is a feat for any aspiring designer. So despite the more cutthroat, competitive nature of luxury fashion markets, there is not a lack of new firms establishing themselves in these fashion centers.

In order for each of the major fashion hubs to maintain their status as capitals of the global industry, each has established its own culture, and therefore attracts different types of designers and companies. New York City, home of famous brands such as Calvin Klein, Michael Kors, and Ralph Lauren, is the youngest of the fashion capitals, as the industry did not boom until the very end of WWII and beyond. New York has a history of catering to high-end fashion while still pleasing the masses, with a recent movement towards ethical clothing design and production (Cusinato et al. 2017). Paris, on the other hand, home to Chanel, Dior, and Louis Vuitton, among other brands, was known originally for its couture, and now for both couture and ready-to-wear fashion. London, home to Jimmy Choo and Stella McCartney, has become a center for more youthful trends and edgy, hipster fashion. Milan houses famous brands, such as Prada and Versace, and is known for relatively affordable high-end and ready-to-wear fashion (Cusinato et al. 2017). In addition to reputation, fashion entrepreneurs must also take the goals and visions for their companies into account when deciding where to establish their businesses. Although significant clusters have formed in each of these cities, the advantages of these clusters

are more catered to the types of fashion companies that have historically operated from these cities.

This is not to say that fashion culture in these cities has always been as it is currently and is not subject to change in the future. Already, the culture in these cities is not the same as it was at the time these fashion empires emerged. In one case, while the Garment District was a major global center for apparel production, the manufacturing sector in New York has greatly declined in favor of outsourcing production. It is this change that has led to the aforementioned emphasis on ethical production in New York (Cusinato et al. 2017). As for London, there has recently been a greater emphasis on maintaining extensive networks (McRobbie et al. 2016). Recently in Milan, new independent fashion designers are establishing small companies with the purpose of relieving unemployment in the city, rather than with the goal of becoming major design houses (McRobbie et al. 2016).

**E. Emerging Fashion Industries**

Several cities and countries have been attempting in recent years to break out into the fashion scene with their own creative contributions. Studies have been conducted on the successes and failures of the fashion industries of Sweden, Canada, Ghana, Uganda, Zambia, The Netherlands (mainly Amsterdam) and many other U.S. cities, like Los Angeles and Seattle. While the majority of these studies have taken a more sociological and analytical approach to the determining the status of these individual fashion industries in the global industry (using interviews of CEOs and designers, participant observation, and/or published content), they provide a good foundation for understanding why certain emerging fashion industries have been able to become major players in the whole market, and why others have not or still have a long way to go. A common theme amongst these pieces of literature is that government policy in

regards to the fashion industry has the largest impact on the successes of these “infant” fashion industries, in addition to some secondary factors such as, the degree of unity and clustering in the fashion community, global attention, and expansion tactics.

With an annual turnover of 64.4 billion Swedish Krona (about $7 billion) in 2005, Sweden has been making headway into the fashion market in recent years (Backstrom and Bauer 2012). Sweden is home to notable brands such as Gina Tricot and H&M, making it a second-tier fashion industry (whereas cities like New York and Paris are first-tier). Backstrom and Bauer (2012) took a firm-level look at the global expansion strategies of these major fashion companies to determine which tactics have been successful for each company. While each company had their own combination of corporate strategies, they found that having strong brand identity and positioning strategy is crucial for any of these companies to hold their ground against competitors and attract the attention of buyers. Brand identity and product differentiation allow fashion companies to assume some degree of brand loyalty from their customers. This makes them stronger competitors and makes it more difficult for new firms to enter the market unless their products are also differentiated in some positive way. Positioning strategy, which involves the density of retail stores, is something for all companies to also consider, as this allows companies to take advantage of external economies. In interviews with the CEOs, it was found that in the case of H&M, taking precautions with global business strategies has been key for expansion, while with Gina Tricot, having tight ownership has been an important aspect of their global expansion. Some Swedish fashion companies have been quite successful in expansion, for example, with H&M experiencing annual growth rates between 10-15% for the past 20 years in the global market. Gina Tricot is a good example of Swedish fashion companies that have been semi-successful, but have experienced recent failures and are thus not fully at the level of a

major global company. Gina Tricot has been taking a slower approach to globalization by focusing on European countries, with successful expansion into Finland and Norway and ongoing attempts in Denmark and Germany (Backstrom and Bauer 2012). The mixed successes of these companies may play a role in Sweden's status as a second-tier fashion industry. Since only particular Swedish companies have a strong global presence, there seems to be an individualistic nature to the Swedish fashion industry. The global success of these few companies overshadows the rest of the Swedish fashion industry, giving the facade of flourishing fashion center. Since individual companies are focusing on their global expansion rather than creating a worldwide reputation for the Swedish fashion industry, the industry as a whole has not been quite able to reach the same status as other fashion capitals. This lack of a "fashion community" appears to be a hindering factor in the Canadian fashion market as well (Brydges and Pugh 2017).

As Brydges and Pugh (2017) found in their interviews with Canadian fashion designers, many designers feel alone and unhopeful for the future, as there is no sense of community within the fashion industry. This feeling is perpetuated by many issues in the Canadian fashion scene. Firstly, while there are a very small number of largely successful, international brands in Canada (like Canada Goose and Lululemon), as well as many highly skilled Canadian designers, there is a lack of support from both local buyers and the government. There is no tradition of buying Canadian fashion brands, which is causing middle market brands to have to change their business practices or just shut down all together, so only very few Canadian luxury brands are able to survive (Brydges and Pugh 2017). With such few fashion companies that survive and no diversity in the size and scope of these companies, it is no wonder there has not been a culture of clustering in the Canadian industry. As for policy, the fashion industry has not yet officially been

recognized as an “orphan” creative industry in Canada, and this is preventing much needed government funding to this industry. With no sources of external capital, it is difficult for new firms to enter the market and for the industry as a whole to grow (Brydges and Pugh 2017).

This “fragmented” nature of the fashion industry has plagued the burgeoning fashion scene in the African countries of Uganda, Zambia, and Ghana as well. According to Langeveng (2017), some interviewees noted the overly competitive atmosphere that seemed destructive to the infant creative industry. While fashion has always been a sizeable part of African culture, previous designers did not engage in Western design practices. Only very recently is there a new generation of designers taught in Western institutes or in the new local African fashion schools. These designers have held fashion weeks, bringing some international attention to African fashion design (Langeveng 2017). However, as emerging fashion industries, the uncertainty regarding the prospects of growth and success have not yet been overcome. These uncertainties are caused by a lack of industry know-how and experience in Western fashion practices with new designers, as they have no predecessors to serve as mentors and examples, as well as little formal institutional support, similar to the industry in Canada. One key distinction with the fashion markets in these three African countries is a strong motivation in the new young, female designers to achieve their entrepreneurial and creative goals, caused by their envisioning of a successful and thriving fashion industry (despite the unclear prospects) (Langeveng 2017). This hopefulness clearly sets these industries apart from the Canadian industry specifically, which could play a role in the different success rates of these emerging fashion industries.

While the individualistic tendencies of developing fashion markets in Sweden, Canada, Zambia, Ghana, and Uganda have been found to burden the growth and success of these industries by undermining the advantages of cluster economies, this is not necessarily the case

with the Dutch fashion industry (mostly concentrated in Amsterdam). In interviews, a majority of fashion designers throughout the Netherlands were found to have chosen location based on “urban amenities” rather than “agglomeration economies” (Wenting et al. 2011). This means that personal reasons, for example where designers and their friends and family live, are more important in choosing startup locations, rather than the benefits of clustering. While there were fashion companies that did cite location and local resources as being important, these were mainly those companies that chose to establish themselves in Amsterdam. And while those designers do seem to have a higher income and a higher degree of success in the fashion industry as a whole, this success is not necessarily attributable to cluster economy benefits. Rather, through regression analysis, it was found that utilizing connections with fellow fashion companies and maintaining extensive networks, as well as learning from past experiences, has contributed to the successes of these Dutch companies and the emergence of Amsterdam as another second-tier fashion center (Wenting et al. 2011).

Even though clustering seemingly has not had the greatest functional impact on the fashion industry flourishing in Amsterdam, it has played a major role in the development of Los Angeles as a second major fashion hub in the U.S. (Williams and Currid-Halkett 2011). Clustering has led to the development of small fashion hubs throughout the U.S. in cities like San Francisco, San Diego, Dallas, and Las Vegas, to name a few. These cities hold smaller scale fashion weeks and are home to well-reputed fashion (or art-related) schools and notable fashion companies, for example The North Face and Gap Inc. headquartered in San Francisco (Joint 2016). However, only the fashion center that has developed in Los Angeles is on a comparable level to the industry in New York City (Williams and Currid-Halkett 2011). The city has been taking domain mainly over high-end casual sportswear design and production, holding its own

Fashion Week. Williams and Currid-Halkett (2011) looked at the clustering in Los Angeles and New York in the four main sectors of the fashion industry: manufacturing, wholesale, supply, and design. The study found that in both cities, there is significant clustering in wholesale and supply. While there is some clustering of manufacturing and design in the fashion districts of both cities, these two sectors have secondary clusters as well. The two separate fashion industries have gained the highest shares of the national U.S. fashion industry in all four sectors. While New York still has the highest shares of design, retail, and wholesale (27.5%, 14%, and 30%, respectively), Los Angeles, has taken the lead in the national share of manufacturing (32.4%). In general, both cities have significantly higher share percentages than any other locations in the U.S., therefore making Los Angeles a major national fashion hub along with New York City (Williams and Currid-Halkett 2011).

### F. Conclusions

Although clustering will always be beneficial for an external economy like the fashion industry, globalization has led to less of a need for the established advantages of the world's 4 major fashion clusters. Burgeoning fashion industries have been established in multiple cities in Sweden, Canada, The Netherlands, Zambia, Ghana, Uganda and the U.S. Whether or not these emerging fashion industries have been as successful as the "Big 4" fashion capitals is still a matter of discussion. While some new industries, like in Sweden and Los Angeles, have shown successes and/or high potential, many other new industries seem to be lacking in their contributions to the global fashion industry. Overall, the success cases seem to be due to individual business strategy and a pattern of clustering similar to the current fashion capitals. Less successful cases, in Canada for example, are largely due to lack of policy, support, and unification of the industry. While many similarities can be drawn between the economic factors

and strategies of the different emerging fashion industries, each industry is different in how it has fared in the global fashion business thus far. And with different histories, governments, and populations, each industry has its own specific prospects for its future presence in the world fashion market, although overall it seems that success of an "infant" industry is possible, but difficult.

This relevant literature provides a good background as to why certain industries are as successful or unsuccessful as they are in the world of fashion. These analyses are expected to support the data and results of this thesis and add insight into the conclusions of this paper, as well as shed light on areas for further research.

# CHAPTER THREE

# METHODOLOGY

The following chapter includes a full explanation and analysis of the model that will be used to determine the success of global fashion companies. Since "success" is a relative term, the fashion companies established in the major fashion capitals will serve as a benchmark for the analysis. Section A will discuss the general analytical framework, Section B discusses data collection and manipulation, and the remaining sections include justifications for the companies and financial indicators used in the analysis.

## A. Analytical Framework

In order to discern the effects that cluster economies have had on fashion companies, this thesis includes a comparative analysis of similar companies established in different locations. Each comparison group will include at least one fashion company that is situated in one of the major fashion hubs and one that was not established in a cluster. By comparing the growth rates and productivity of capital for these companies, it can be determined as to whether the clustering of the fashion industry has really led to the success of some fashion companies over others. These conclusions will then indicate whether success is possible for the "infant" fashion industries where these companies are located. Since the definition of "fashion" is not very clear-cut and can include a broad range of companies, this analysis includes a few different categories of companies within the global fashion industry. The categories are as follows: fast-fashion retailers, luxury designers, and sportswear companies. While these categories are not exhaustive, they cover a wide range of the companies that do fall under the definition of the fashion industry included in the introduction of this paper. Another category that would have been a good addition would be small boutique stores, rather than chains. This would give an idea about how

cluster economies affect firms that are not necessarily looking to expand globally or to have a widely known brand name, but still would like the benefits of fashion clusters. However, data of this type would be very difficult to obtain, so this category of fashion company was left out of the analysis.

For each of the companies chosen for the study, financial data was collected over a period of 10-18 years and certain indicators were calculated. These indicators include annual sales growth, profit margins, and productivity of capital. These results are then compared to see if those companies founded in countries and cities other than the four main fashion capitals have comparable numbers to those founded in fashion clusters. Since the companies in the study were specifically chosen for their location, differences in the data will be representative of the effect that clustering has had on the success of these fashion companies.

**B. Data Set and Conversion**

All raw data used in this thesis are from published corporate annual reports and financial statements found on the official company websites (for the 11 companies outlined in the next section). Thus, all companies included in the data set are publicly traded for ease of data collection. While this means that the list of companies to choose from for the analysis was limited, the conclusions of the analysis are still applicable to all firms in the fashion industry, public or private. The data sample consists of annual values and spans a period of 18 years from 2000-2017.

Annual data were chosen over quarterly data for a few reasons. The first reason is that the guidelines for calculating quarterly data are inconsistent and vary with each company. For example, H&M releases year-to-date figures each quarter, meaning they release financials for the first three months of the fiscal year, then the first six months, then the first nine months, and

finally the whole year. Other companies, like Christian Dior release total financial figures from each individual 3-month quarter. Another reason for using annual data is that the scope and availability of quarterly data varies greatly for each company. Some companies have released quarterly data as far back as 2003, while others may only have data that goes as far back as 2011. This makes comparisons difficult. Quarterly data is also much more volatile than annual, especially with products that are seasonal. Often times a company may have positive profits one quarter and then negative profits the next quarter, so calculating a growth rate between those two values would not be indicative of any pattern or general financial standing. Thus, annual data is the most helpful for looking at the bigger picture and making comparisons between different companies.

It is important to note that since the companies chosen for this study are headquartered all over the world, their annual reports and financial statements are published in dollars, euros and other currencies. While the indicators I have chosen to look at are percentages rather than currency values, it is still a good idea to convert all values directly from the financial statements into the same currency, in this case U.S. dollars. Monthly exchange rates of dollars for one euro were obtained online from the Federal Reserve for Economic Data (FRED) and were averaged to get annual exchange rates for each year from 2000 to 2017. These values were then used to convert all euro amounts to dollar amounts before further manipulation. The same methodology was used to convert values reported in Swedish krona and British pounds into U.S. dollars.

**C. Justification for Company Selections**

As mentioned earlier, all companies in this analysis are publicly traded, so this has played the largest role in the selection of the fashion companies for the study, as well as their location.

**Fast Fashion retailers:** For this first comparison group, the companies chosen are Abercrombie & Fitch, Hennes & Mauritz AB, Industria de Diseño Textil, S.A., and Fast Retailing Co. Ltd. Although it has since moved it headquarters, Abercrombie & Fitch was founded in Manhattan, New York City in 1892 (Britannica 2011). For this reason, Abercrombie & Fitch serves as the benchmark case for this comparison category. It is traded under the stock symbol ANF on the NYSE (FashionUnited 2016). Hennes & Mauritz AB, more commonly known as H&M, was founded in 1947 and is headquartered in Stockholm, Sweden (H&M 2019). It is publicly traded on Nasdaq Stockholm as HM B (FashionUnited 2016). Industria de Diseño Textil, S.A., more commonly known as Inditex, was founded in 1985 in Arteixo, Spain. Inditex is globally known as the parent company of Zara (it's flagship store), although it owns other chains as well (Orwig 2018). Inditex shares are traded under the symbol ITX on BMAD (Bolsa de Madrid), one of Spain's regional stock exchanges (FashionUnited 2016). Fast Retailing Co. Ltd. is a public retail holding company founded in Yamaguchi, Japan in 1963. Currently, its most well-known subsidiary is Uniqlo Co. Ltd., with the global clothing chain Uniqlo (Fast 2010). Fast Retailing Co. Ltd. is traded on the Tokyo Stock Exchange (TYO) and the Stock Exchange of Hong Kong Limited (SEHK) (FashionUnited 2016).

All of these companies fall into the retail industry, as they have a focus on relatively upscale but still casual and affordable fashion for young consumers, rather than couture or luxury fashion. All have well-known multinational retail store chains that quickly update their clothing styles with the changing seasons and fads. This makes them a very comparable group. Sweden is a second-tier fashion industry (as mentioned in Chapter Two) and there is no significant clustering of fashion companies in Arteixo, Spain or Yamaguchi, Japan, so comparing the

companies from these locations to the company founded in NYC will provide useful insight into the thesis question.

**Luxury Fashion Designers:** For this comparison group, the companies are Christian Dior SE, Burberry Group PLC, and Hugo Boss AG. Christian Dior SE, more commonly known as just Dior, was founded in 1946 in Paris, France (Sowray 2017). It is traded on Euronext under the stock symbol CDI (FashionUnited 2016). Burberry Group PLC, or just Burberry, was established in 1856 and is headquartered in London (Burberry 2019). It is currently traded on the London Stock Exchange (LSE) as BRBY (FashionUnited 2016). Hugo Boss AG, commonly referred to as BOSS was founded in Metzingen, Germany in 1924 (Doig 2016). It is traded on the Frankfurt Stock Exchange (FWB) under the symbol BOSS (FashionUnited 2016).

It is worth noting that the majority of these companies are founded in one of the four major fashion capitals. In the company selection process, this seemed to be the case with most of the luxury fashion houses. This is likely because many high-end luxury brands are focused on couture fashion, so there is an emphasis on unique and inspired designs of the highly-skilled designers. These designers often gravitate towards the major fashion cities in order to take advantage of schooling and apprenticeship opportunities. Dior and Burberry will both serve as benchmarks for the analysis of Hugo Boss's success.

**Sportswear fashion:** This comparison group consists of Nike, Inc., Adidas AG, Puma SE, and Lululemon Athletica. Nike, Inc. was founded in 1964 in Beaverton, Oregon (Britannica 2018). It is traded on the NYSE under the ticker NKE (FashionUnited 2016). Adidas and Puma were both founded in 1949 in Herzogenaurach, Germany by rival brothers (Lewis 2017). Both are traded on the Frankfurt Stock Exchange (FWB) as ADS and PUM, respectively

(FashionUnited 2016). Lululemon was founded in 1998 in Vancouver, Canada (Lululemon 2019). It is traded on the NASDAQ with the stock symbol LULU (FashionUnited 2016).

Here it is important to note that none of these companies were founded in major fashion capitals. This seems to be the case with most sportswear fashion firms. This is likely for the opposite reason that most of the designer firms were founded in fashion capitals. Design is not as important to making athletic wear as mass production and distribution is. So these companies are likely to establish themselves in places where they can invest in production factories rather than highly skilled designers. This is supported by the fact that Abercrombie & Fitch began as a sportswear company when they were founded in New York City, however it has since had to expand and adjust its product lines to remain on top (Britannica 2011).

These companies all have the similar products as well as similar global scopes, so they are quite comparable. It will be especially interesting to compare the financial successes of Adidas and Puma since they were established in the same place at the same time as actual rivals. If one of these two companies is significantly more successful than the other, then it will be beneficial to know the factors that contributed to that company's success (although location and clustering is not likely to be a contributing factor).

**D. Justification for Indicator Selections**

**Sales growth:** One obvious indicator if a company is doing well is growth in sales and sales revenue. This indicator was calculated year by year for each company, as well as an overall average annual growth rate for the whole time period. An increase in sales is a good sign for a company, because this means there is a higher demand for their products and more customers. Since fashion companies established in fashion capitals have more opportunities to interact with buyers, better publicity through magazine publications and fashion week participation, and

quicker access to design and production labor, it is likely that there sales will experience higher growth than those companies established elsewhere.

**Profit Margin:** As indicated by its name, profit margin is a calculation of the profitability of a firm. It is reported as a percentage and calculated as net income divided by net sales. This measure tells you the amount of profit that is made for each sale. Typically firms can charge a higher price if their products are high quality and more desirable, thus garnering higher profits. So the higher the profit margin, the more profitable and therefore successful a firm is. Thus, this can be used as a measure of success or failure in the industry.

**Rate of return on capital:** Return on capital is another profitability measure. It indicates how well a firm is using its capital to generate profits. The higher the rate of return, the more successful a company is. This measure is calculated as the earnings before interest and taxes divided by capital employed. If capital employed is not recorded on the balance sheet of the financial statements, then this number can be derived by subtracting current liabilities from total assets.

All of the above indicators will be recorded in percentage form. This is done specifically because it would be unfair to directly compare a larger company to a smaller company. A company may be smaller because it has been around for a shorter amount of time, has less capital invested, or simply because it does not wish to be of a large scale. This does not mean that the smaller company is less profitable or successful than a larger company. This is a relative measure, so using a percentage will account for many of the factors that may differ between the comparison companies.

**Global expanse:** While this measure is not necessarily quantifiable, it is important for a leading company in the fashion industry to be prevalent in the global market for fashion. More

successful companies tend to be those that have significant sales and customer base in multiple regions around the world. Thus the presence of these companies in different markets will be included in the discussion and analysis in Chapter Four.

**E. Conclusion**

This chapter has outlined the methodology for finding and calculating data and results. It has also introduced the analytical framework that will be used to interpret the results in the next chapter. Chapter Four will now take a look at each company's financial standing in relation to the whole comparison group, as well as then comparing the different fashion categories to each other to get a larger overall picture of the global fashion industry.

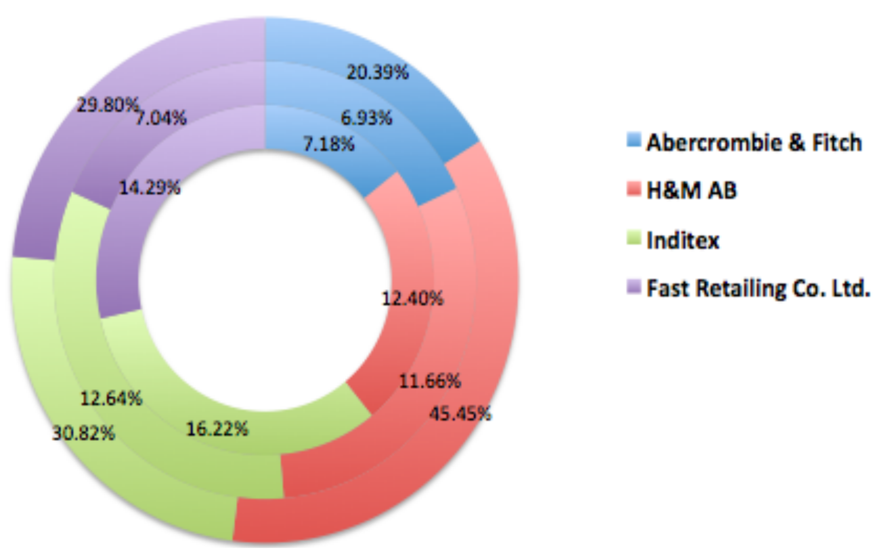
## CHAPTER FOUR

## RESULTS AND ANALYSIS

Now that the analytical framework has been outlined, this chapter will include a more in depth analysis of the quantitative results. This analysis first compares the average values of the indicators for each company one category at a time, and then it looks at the annual trends in the data from 2000 to 2017. A discussion of how each company performed in the context of their respective economy during the Global Financial Crisis of 2008 is also included, as well as the international market reach of the companies.

### A. Fast Fashion Retailers

**Figure 1: Average indicator values for Fast Fashion Retailing.** The outermost ring represents rate of return on capital, the middle ring represent profit margin, and the inner ring represents sales growth.



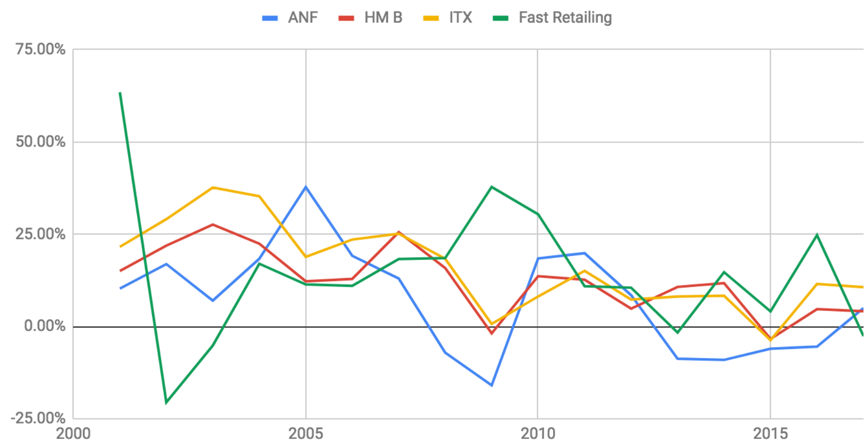

Data obtained from published company annual reports.

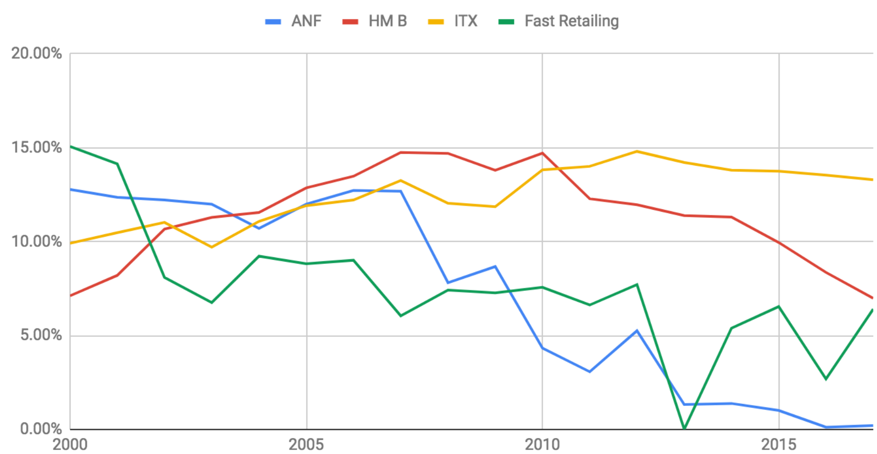
Based solely on the average values of sales growth, profit margins, and rate of return on capital in Figure 1 above, the group is outperforming the benchmark company, Abercrombie. With an average annual sales growth of 7.18%, Abercrombie & Fitch's performance is half that of H&M, Inditex, and Fast Retailing Co. (with annual sales growth rates of 12.40%, 16.22%, and

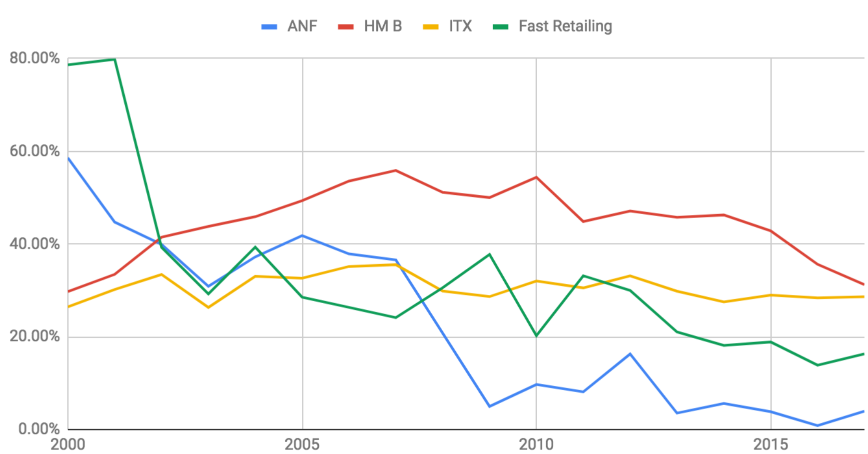
14.29%, respectively). Similarly, Abercrombie and Fitch's average profit margin is 6.93%, which is about half of H&M's 11.66% and Inditex's 12.64%. Fast Retailing Co. has an average profit margin of 7.04%, which is similar to Abercrombie's, although still slightly higher. Average rate of return on capital for this group has a very wide range. H&M has a very large return on capital of 51.84%, while Inditex and Fast Retailing Co. are below this at 30.82% and 29.80%. Abercrombie has the lowest average return on capital of 20.39%. This is less than half of H&M's rate of return on capital and 33% less than the rates for Inditex and Fast Retailing Co. Since for all of the indicator values, the companies not founded in a fashion capital outperformed the benchmark company, this indicates that being located within a fashion cluster is not necessary to the success of a fast fashion company.

Comparing the trends in Figure 2, sales growth for Abercrombie & Fitch, H&M, and Inditex all seem to be following a similar path. All of these companies differ somewhat in their values of sales growth each year, but they keep relatively in line with each other and each company exhibits the highest and lowest sales growth of the three at some point throughout the 18-year period. Fast Retailing Co. is the outlier here because a few times during this period, the company has significantly lower sales growth (like in 2002) or significantly higher sales growth (in 2009) than the other three companies, but in recent years the company levels out. Trends in profit margin, however, tell a much different story. From 2000 to 2017, the values for profit margins for all four companies slightly converge and then greatly diverge. Abercrombie profit margins slowly deteriorate over time. Fast Retailing Co.'s profit margins also decrease, although this is in lesser magnitude and intensity as Abercrombie & Fitch. H&M sees a general increase in the 2005-2010 period, but then their profit margins drop back down. Inditex has had a slight increase in its profit margins over this time period.

**Figure 2: Annual Sales Growth, Profit Margins, and Return on Capital for Fast Fashion Retailers 2000-2017.**




Data obtained from published company annual reports.

Rate of return on capital declines during this time for Abercrombie & Fitch and Fast Retailing Co Ltd. For Inditex this value stays roughly the same over the 18-year span, and H&M there is a pattern of increasing slightly and then dropping back down to the original value, similar to with profit margins. Overall, this means that in recent years, the companies not founded in fashion capitals seem to be doing just as well and even better than the benchmark company in all three measures of financial success. As Abercrombie & Fitch is on the decline, other fast fashion retailers seem to be picking up the slack.

It is also easy to see the effects of the 2008 global financial crisis on all four of these firms in Figure 2. Abercrombie and Fitch suffered a large decline in sales growth, profit margins, and return on capital at the time of the recession (2008-2009). Beginning in 2010, Abercrombie was able to bring its sales back up after the shock to consumer spending, however profit margins and rate of return on capital were and are still close to 0%. Inditex also received a similar negative shock to sales growth during the crisis (although not as large in magnitude as the shock that Abercrombie received), but was able to maintain its profit margins and return on capital during and after the recession. H&M experienced a drop in sales growth almost identical to Inditex. As for profit margins and return on capital, while H&M was on a slight incline before the crisis, following the crisis profits and return on capital began to decline. However, H&M managed to keep profit margins and rate of return on capital at the same level they were at in the early 2000s. Thus, H&M and Inditex were able to do a better job of handling the crisis. It makes sense that Abercrombie & Fitch was the most affected by the financial crisis, since the crisis began in the U.S., and this likely the reason why Abercrombie had trouble recovering. However, even if it took a few years longer than H&M and Inditex, Abercrombie should have been able to recovery eventually. Fast Retailing Co. is the outlier here, experiencing a sharp increase in sales

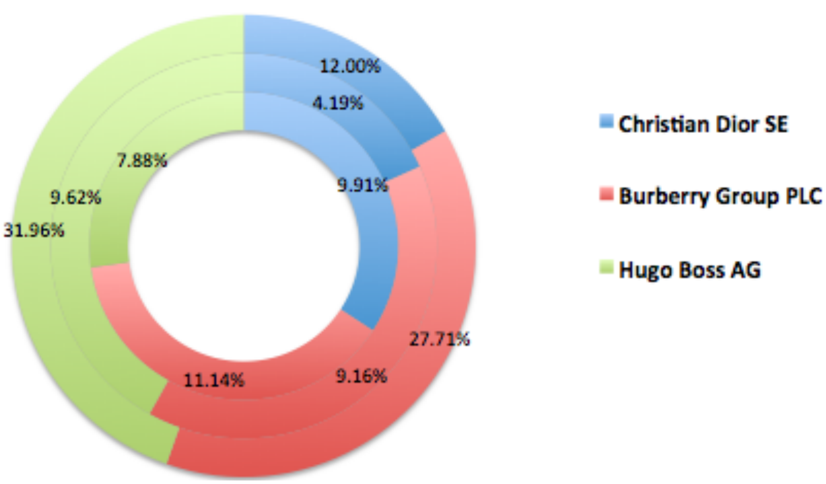
growth during the financial crisis, and increases to profit margins and return on capital as well. This is noteworthy since Asia was also hit by the financial crisis, so Fast Retailing Co. would be expected to experience a decline. According to Fast Retailing Co.'s 2009 Annual Report, this increase in performance is because of their emphasis on providing high-quality basic and casual clothing at affordable prices. In the report, the company attributes its success to opening new store locations in high-profile locations, which increased brand reputation. Also during this time, Fast Retailing Co. released new, low-cost product lines. This included jeans, tops, and shoes all at affordable prices, which attracted consumers who were trying to cut their expenditure. Based on this, it is clear that the fast fashion companies not founded in fashion capitals showed more resilience to the economic turmoil of the 2008 - 2010 period.

In terms of global market influence, Abercrombie & Fitch can attribute 63% of net sales to the U.S. and 37% of sales internationally. H&M mainly operates in the U.S. and relies heavily on American customers. H&M currently operates in 69 national markets, with plans for expansion into even more in the near future. According to the 2017 Annual Report, H&M's top profitable markets are Germany, US, UK, France, China, Sweden, Italy, Spain, Netherlands, and Norway. While the majority of these are in Europe, it is important to note that none of the top 5 markets are Sweden itself, rather they span Europe, the Americas, and Asia. According to the 2017 Annual Report for Inditex, 16.3% of sales happen in Spain, 44.9% happen in Europe, 15.6% in the Americas, 23.2% in Asia and others. In total Inditex serves up to 96 markets worldwide. Thus although the sales are a little more concentrated in Europe, there is still a slightly significant percentage of sales attributable to other global markets. As shown in Fast Retailing Co.'s 2018 Annual Report, the majority of Fast Retailing Co.'s revenue comes from the UNIQLO brand. Currently, Japanese revenues are larger than total international revenues,

although the two values have been converging (810.7 billion yen and 708.1 billion yen for Japanese and International sales, respectively). According to the report, the company projects that in the coming years, UNIQLO international revenues will overtake Japanese revenue, with a much larger number of international stores. By 2022, it is expected that International sales will be double Japanese. With this analysis, it has become clear that the companies not founded in fashion capitals have had much better results when it comes to getting their brand name globally recognized and desired.

### B. Designer Fashion

**Figure 3: Average indicator values for Designer Fashion Houses.** The outermost ring represents rate of return on capital, the middle ring represent profit margin, and the inner ring represents sales growth.



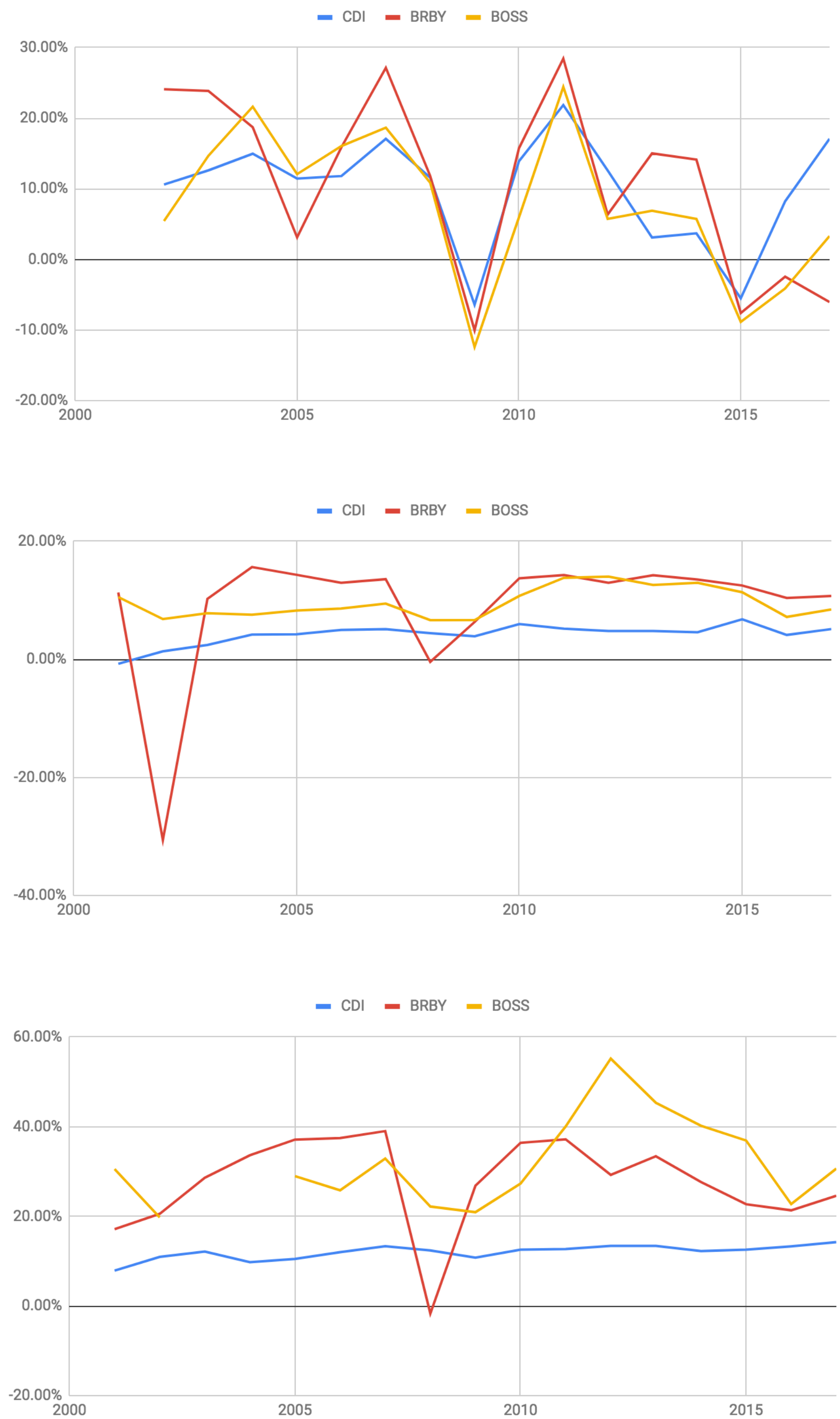

Data obtained from published company annual reports.

Looking at average values in Figure 3, it seems as though Hugo Boss is faring well compared to the benchmark companies Dior and Burberry. In terms of average annual sales growth, Hugo Boss is admittedly lagging, with a growth rate of 7.88%, while Dior and Burberry have 9.91% and 11.14%, respectively. However, with profit margin, Hugo Boss is right in line with Burberry, being at 9.62%, while Burberry is at 9.16%. Dior actually seems to be lacking in

profit margin, not even making half of the other companies, at a mere 4.19%. Similarly, with average rate of return on capital, Hugo Boss has reached a performance level on par with Burberry (in fact slightly higher than) and exceeding Dior. Hugo Boss's average return on capital is 31.96%, while Burberry's is 27.71% and Dior's is 12.00%. These results seem to suggest that location in a fashion capital does not matter in for a designer fashion firm to be successful, at least specifically for a company starting in Germany. While it is not necessary, though, it does seem like it may have some benefits to it, especially in terms of sales growth. This is likely due to more opportunity for recognition and brand-name building in fashion hubs.

Now looking at trends over the 2001-2017 period in Figure 4, all three of these firms have had remarkably similar patterns and values for their annual sales growth, with negative and positive sales growth in the same years. This includes a major decline in 2009, followed by a peak in 2011, and another decline in 2015. After this last decline, Dior has slowly been regaining sales growth, while Burberry is still negative, and Hugo Boss is slightly positive. As for profit margin, Hugo Boss has consistently remained at the top as compared to the benchmark companies. Burberry experienced some negative profit margins in 2002 and 2008, however, during the rest of this time period, Burberry has had similar performance to Hugo Boss. Christian Dior has remained at roughly 50% of Hugo Boss and Burberry's profit margins during this time. In the first half of this time period, Burberry had the highest return on capital, followed by Hugo Boss and then Dior. However, following Burberry's major drop to negative return on capital in 2008 (in line with the drop in profit margin in 2008 and most likely due to the global financial crisis), Hugo Boss sharply increases their return on capital to surpass Burberry's highest point and reach 55.18% in 2012.

**Figure 4: Annual Sales Growth, Profit Margins, and Return on Capital for Designer Companies 2001-2017.**




Data obtained from published company annual reports.

Burberry was able to bring their return on capital back up following that significant drop, but not more than Hugo Boss's level. Dior's return on capital stays relatively stable at about 12-14% during this whole time. This means that despite being located in a German city, Hugo Boss has been able to keep up with and even surpass Dior and Burberry's performance. So for a designer fashion company, while being located in a fashion capital gives proximity to major events like bi-annual Fashion Weeks, it is not necessary for success.

While all three of these designer firms experienced the same very sharp decline in sales growth from the financial crisis (due to the fact that luxury items are the first to be cut out of consumer spending), only Burberry seems to experience a sharp decline in profit margin and rate of return on capital in 2008. This means that Dior and Boss were relatively resilient to the economic downturn. According to Burberry's 2008-09 Annual Report, Burberry's response to the global crisis was to conserve cash and reduce its capital expenditures. The strong reaction of Burberry to the economic decline is what caused the evident decline in Burberry's profit margin and return on capital. This suggests that Burberry was just being extra cautious and simply trying to prevent profits and return on capital from becoming negative, because in the long term this would be the most beneficial. This was a good strategy for Burberry, as its profit margin and return on capital were able to recover. Overall, both the designer company based in a fashion capital and the designer company not based in a capital were able to remain relatively unaffected by the financial crisis (in terms of profit and return on capital), so this suggests that there is no significant benefit to being located in a fashion capital during an economic crisis. However, when a designer company based in a fashion capital was affected by the crisis, it was able to quickly recover, so location in a fashion capital could prove beneficial to a designer firm if it were to be directly affected by a financial crisis.

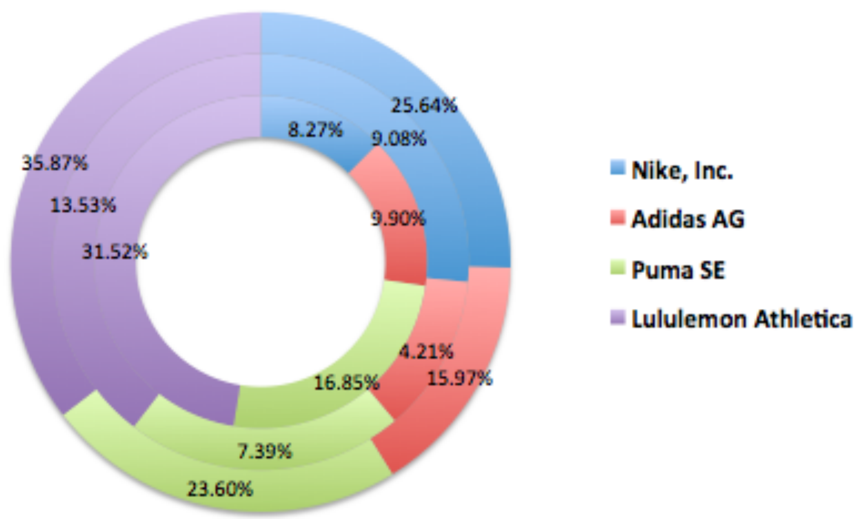
In terms of global market presence, Burberry mainly operates in Asia Pacific, the Americas, and EMEIA (Europe, Middle East, India, and Africa. According to Burberry's 2017/18 Annual Report, 41% of sales were attributable to Asia Pacific, 36% to EMEIA, and 23% to the Americas. About 82% of these sales happened through retail, while the rest can be attributable to wholesale and licensing. Christian Dior reported 29% of sales in Europe, 25% in the U.S., 35% in Asia, and 11% elsewhere in their FY 2017 Annual Report. On the other hand, according to the 2017 Annual Report for Hugo Boss, 62% of sales were attributable to Europe, 21% to the Americas, and 14% to Asia-Pacific. The remaining 3% of sales were from product licensing. Since all three of these companies have been founded in Europe, the fact that Burberry and Dior reported the highest sales in Asia is noteworthy. Also, the general distribution of sales for those two groups is more spread out (no single region takes 50% or more of sales) than can be said for Hugo Boss. Hugo Boss's sales are more concentrated in their main region of operation, which is Europe. This indicates that those companies located in fashion clusters have been more successful at worldwide distribution and market penetration than a company not based in a cluster.

**C. Athletic Wear**

This group is slightly different in that it has no benchmark company. Major sportswear fashion companies are not located in any of the fashion capitals. Abercrombie and Fitch started off as an athletic wear company in New York. It has since however changed its product base, which further indicates that sportswear fashion is not profitable for firms starting in one of the big four fashion capitals. Despite none of the selected companies being located in fashion clusters, they have still have managed to garner high sales growth rates, profit margins, and returns on capital. Nike and Adidas have roughly similar sales growth rates of 8.27% and 9.90%,

respectively as shown in Figure 5 below. Puma has double this growth rate, with an average of 16.85% growth. In terms of profit margin, Nike has actually outperformed Puma with an average of 9.08%, but Adidas is at roughly half the growth rate of Puma (those being 4.21% and 7.39%, respectively). A very similar trend has happened with the values for average rate of return on capital, with Nike being at 25.64%, Adidas being at 15.97%, and Puma being at 23.60%.

**Figure 5: Average indicator values for Sportswear Fashion Companies.** The outermost ring represents rate of return on capital, the middle ring represent profit margin, and the inner ring represents sales growth.




Data obtained from published company annual reports.

While Puma's performance level is not double that of Adidas, it is still significantly higher. For all of these values, Lululemon significantly outshines the rest (31.52% average sales growth, 13.53% average profit margin, 35.87% average return on capital). This may be due to the fact that Lulemon went public much later than these companies, so there is less time for fluctuation in these values (which the other companies are all vulnerable too). Another explanation, especially for the higher sales growth, could be that since Lululemon is much younger than the other companies, there is a higher more potential for improvement and growth. Regardless, it seems as

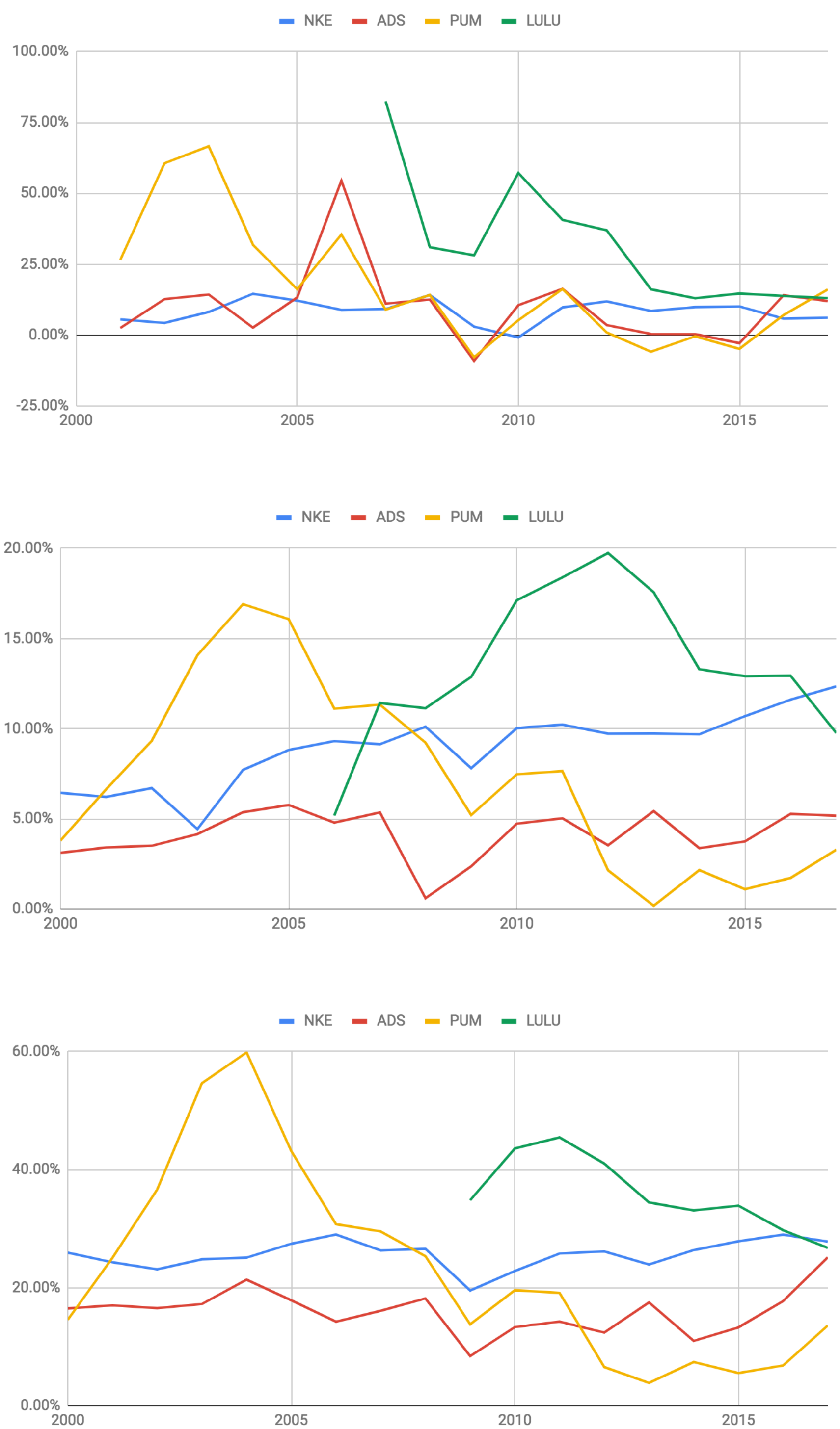
though despite none of these companies having the benefits of cluster, they are all fairing well financially, with the exception of Puma outperforming Adidas. The latter is the case because Puma and Adidas are headquartered in the same city, although the city isn't a cluster. Thus there seems to be no benefits to being near another fashion company like your own; instead, there is more direct competition to account for.

In Figure 6, it seems as though all four sportswear companies have converged to a similar level of sales growth over the years. From 2000 to 2005, annual sales growth of Puma far outweighed the similar sales growth of Adidas and Nike. Following a brief stint at the top by Adidas in 2006, the three sportswear fashion firms converged to similar growth performance. Around this same time (about 2007) is when Lulemon went public, so Lululemon has significantly higher sales growth at first, before eventually dropping down to the same level as the other three athletic companies. There is no clear trend in profit margins for these companies during this time period. Before 2007, Puma had roughly double the profit margins of Nike and triple that of Adidas. However, once Lululemon came into the picture in 2007, this dramatically changed. Lululemon performed significantly better than the other firms, peaking at a 19.74% profit margin in 2012. Nike's profit margins have remained relatively stable since then, other than a slight decline in 2009. Similarly, Adidas experience a drop in profit margins in 2008 with the financial crises, but has since brought their margins back to the same pre-crisis level. Puma was not as successful, with its profit margins continuously declining significantly below all of the other companies. Rate of return on capital for these four companies exhibit similar trends as profit margins, the only difference being that Lululemon, Nike, and Adidas have reached similar performance levels now, with just Puma lagging behind. These trends mean that although none of these firms are based in fashion capitals, they all have individually been able to reach similar

levels of sales growth, profit margins, and rate of return on capital. With this relative consistency and the lack of public sportswear companies founded in fashion capitals, the average of these companies can be used as the benchmark values for their success. Thus, all of these companies have been successful in the global market at some point since 2000.

It is also apparent from Figure 6 that Nike, Adidas, and Puma have experienced similar dips in their sales growth, profit margins, and return on capital in the 2008-2010 period from the 2008 global financial crisis. While all three of these companies were able to recover their levels of sales growth following this decline, only Nike and Adidas were able to recover their pre-crisis levels of profit margin and return on capital. Puma remained at low-levels of these two indicators, most likely due the increased success of Adidas. Since these two companies are located in the same German city, the two are direct rivals. Thus, in Figure 6 one of the two companies is almost always significantly outdoing the other. Lululemon is the outlier here, similar to how Fast Retailing Co. is the outlier in the Fast Fashion Retail group. While sales growth for Lululemon did decline during the recession, profit margin and return on capital increased during that time. Based on Lululemon's 2010 Annual Report, this is most likely due to the fact that Lululemon was undergoing rapid growth during this time period, having just recently gone public. However, Lululemon has acknowledged that decrease in consumer spending due to the crisis would likely affect their profits and returns eventually, and this delayed response to the poor economic conditions can be seen for profit margin and return on capital in Figure 6.

**Figure 6: Annual Sales Growth, Profit Margins, and Return on Capital for Sportswear Companies 2000-2017.**




Data obtained from published company annual reports.

Overall, it seems as though the performance for athletic wear companies was very scattered before the financial crisis, due to none of these firms being located in financial capitals. Post-crisis these companies have all been trying to recover from the economic decline and are therefore much more equal in their performance level than before.

In the 2017 Annual Report, 46% of Nike's sales were from US sales, while 54% were from international sales. Roughly 66% of Nike stores are located in many countries internationally, while 34% are located in the U.S. Since Nike is a U.S.-based country, the higher percentage of international shares shows that Nike has made considerable headway into global markets. According to Adidas 2017 Annual Report, 21% of sales were attributable to North America, 9% to Latin America, 29% to Western Europe, 19% of sales to the greater China area, 3% of sales to Russia, 5% to Japan, and 14% to MEAA (Middle East, Asia, and Africa). This is a relatively very even distribution of sales and indicates that Adidas has wide global recognition. For Puma, the EMEA region (Europe, Middle East, Africa) accounted for 39.8% of sales, while the Americas accounted for 36.1%, and Asia/Pacific 24.1%, as stated in the 2017 Annual Report. This is also a fairly even spread across three major regional markets. While Lululemon does not explicitly state the amount of sales contributable to their regional markets, since the majority of revenues currently come from store sales, the number of stores can give insight into this. Lululemon currently has 57 stores in Asia/Pacific and 13 stores in Europe, one of which is a flagship store located in the fashion capital of London. Overall 46 new locations were opened in the last year, 30 in North America, 13 in Asia/Pacific (9 in China), and two in Europe. While this is not as evenly distributed as the other sportswear companies, for a company as new as Lululemon this is a good start and there are further plans for global expansion, especially through digital markets.

### D. Conclusions

For fast fashion retailing, it seems as though locating in a non-fashion cluster has advantages over locating in a fashion cluster. Sales growth, profit margins, return on capital, and global distribution were all generally better for those companies not founded in the fashion capitals. This may be because from the get go there is an emphasis to work harder and do more global outreach, since the benefits of the cluster work there. These individual companies surely initiate many more growth tactics and strategies, which all add up to high performance. This also seems to have made these companies more resilient to the economic turmoil in 2008. This is a sign that these companies are financially strong and can, therefore, be leaders in the industry. Abercrombie and Fitch, on the other hand, may have taken its location for granted and focused much more on the local market, leading to less success and higher susceptibility to problems in the U.S. market.

For designer companies, it seems as though sales growth, profit margins, and return on capital all have the potential to be the same regardless of whether or not you are located in a fashion capital or not. However, it is clear that global recognition and brand distribution is higher for those firms that are located within the fashion capitals. This is likely due to more opportunity to participate in Fashion Week and related events, as well as more exposure to local fashion media coverage. In times of economic downturn, a designer firm located within a fashion capital was able to quickly recover when it was impacted by the decline. Thus a designer company may want to strongly consider basing itself in an established fashion cluster because although success is possible elsewhere, it will take more effort on the part of management than need be.

For sportswear fashion companies, it seems as though despite not being located in fashion clusters, Nike, Adidas, and Puma became successful leaders in the industry, with similar sales

growth, profit margins, returns on capital (resulting from recovery from the financial crisis), and widespread distribution in regional markets. Lululemon has since joined the competition, and while it still has a ways to go to be as recognized as the other three on the global scale, it is financially in a good spot and shows promise.

Thus, depending on the type of fashion category a company and industry falls into, setting up headquarters in an established fashion capital or elsewhere may or may not be beneficial for the success of the company.

# CHAPTER FIVE

# CONCLUSION

## A. Review of Findings and Implications

With a long-standing history of clustering, the modern global fashion industry is largely located in New York, London, Paris, and Milan. While initially it seems that in the future the fashion industry will remain mostly in these few fashion capitals due to the benefits of clustering in industries that exhibit external economies, there actually appears to be less of a need to depend on these few "fashion capitals" to build a new fashion empire. This is most likely due to: 1) an increase of globalization that allows new brands to get their name and product out in the world markets more easily and 2) outsourcing of production which causes companies to be more strategic with the cost of their location. This is why recent research has been exploring the possibility of growing fashion industries in other countries and cities. While the previous literature on the fashion industry has focused on government policies, societal perception of the fashion industry, level of industry experience, and other economic factors that have hindered or helped the burgeoning fashion industries in individual countries like Canada, Sweden, and Uganda, this thesis has been able to provide a new, firm-level based perspective on the future of the global industry.

Although theory suggests that certain industries, especially the fashion industry, exhibit external economies of scale and form in clusters for economic reasons, there are no definitive benefits from operating a firm in the major fashion clusters. This is not to say that there are no benefits, but the possible benefits are largely dependent on the type of fashion company. As this thesis found, designer companies were able to benefit in terms of global reputation, regional distribution of sales, and resilience to economic downturns. The designer firms located in Paris

and London had a fairly even distribution of sales across Europe, Asia, the Americas, and elsewhere, signifying that their brand name and client base extends to all of these regions. The designer firm located in Germany had a much higher percentage of sales in Europe than elsewhere, showing that its brand name has not spread far beyond the local region. Fast fashion retailers and sportswear companies, on the other hand, performed the same or were even better off in their financials, in the contexts of the global fashion industry and the global economy, and they also had a wider distribution of sales outside of the fashion clusters. This means that while it still does depend on the category of fashion, in general new fashion companies have the potential to successfully operate from any city around the world. These results imply that, if many fashion firms decide to set up headquarters and operate from the same new city, this city could become a fashion cluster and a new capital of the global fashion industry. The benefits of clustering and established advantages in the current fashion capitals can in fact be overcome by “infant” fashion industries. More specifically, this has been the case in Metzingen, Germany; Herzogenaurach, Germany; Vancouver, Canada; Stockholm, Sweden; Arteixo, Spain; and Yamaguchi, Japan, although these results can also be applicable to any other cities.

This means that up-and-coming fashion entrepreneurs have good prospects for success in any new city or country, but more specifically in the cities and countries included in this study. They can apply the growth strategies of the companies in this analysis that fall under the same category of fashion as they aspire to be. This would include, for example, launching multiple high quality, yet affordable fashion lines at once in the fast fashion industry as Fast Retailing Co did. Also, another possible tactic, helpful to all types of fashion companies, would be expanding the company by opening many new locations in high profile areas. This would lead to positive exposure and an increase the value of the company’s brand name.

## B. Recommendations for Future Research

The results in this thesis are interesting in that they refute the widely accepted economic theory of external economies of scale for the fashion industry. Further research could be done on each individual company to determine which factors, including location, could have led to its success. This could be a regression analysis looking at the effect of variables such as location, GDP, distribution of sales, and management strategies on the sales or profitability of each firm. This would give a measure of the effect that location has had on the successes of these companies, if it does end up being significant.

Furthermore, a limitation of this thesis is that it has used firm-level data to make conclusions about the larger fashion due to a lack of city or country level data. While the successes of individual firms can indicate overall industry success, this does not necessarily have to be the case in all situations. So as city or country-level data become available, completing an analysis at this higher level would provide more direct insight onto the success of infant fashion industries within the whole industry. The four current fashion capitals all have sizeable shares of the international market for fashion. So in order for another city or country to be as successful as these cities have been, it would have to have garnered a substantial share of the global fashion industry. Thus an analysis of this type would involve comparing the market share of the global fashion industry of individual cities and/or countries to the market share of the fashion capitals. Looking at the degree of clustering in each location will also give insight into how much of the market share of these individual industries is attributable to clustering and external economies of scale.

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