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A fashion purchase not to be made on impulse

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Is the fashion sector different in Eastern Europe from Western Europe? What obstacles do companies face when growing their business?

At the beginning of 2008, Marek Piechocki, the president of LPP, was looking for ways to make the company's business grow even faster than it had up to that point. The firm's three retail fashion chains - Reserved, Cropp and Esotiq - operated a total of 345 stores, with 149,000 square meters of floor space, and the outlook was good for continued organic growth.

But the sector was showing signs of having reached maturity, and launching a new retail fashion chain seemed like a very difficult venture. For several months, Piechocki and his management team had been thinking about buying Artman, a competing company that owned the House chain of fashion stores. If acquired and incorporated into the LPP group, Artman could generate faster growth and be very profitable. The acquisition price, though, was 50 percent higher than Artman's market value. The basic question was whether or not LPP should acquire Artman-House.

Entrepreneurial spirit

Piechocki was born in Kartuzy, a small town 60 km. from Gdansk, Poland's sixth-largest city. His mother had a grocery store, but the young Marek opted to study civil engineering. As it turned out, his future did not lie in this area either. In 1989, when the Berlin Wall fell, his friend Jerzy Lubianiec suggested they fly to Singapore to buy goods as if they were tourists

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and then sell the merchandise to Polish retailers.

They started with electronic goods and later moved on to clothing. Later they decided to concentrate on purchasing garments in China and create their own brands and designs. The imported garments were sold to Polish wholesalers and retailers. Thus LPP was born.

In 1993, LPP had a turnover of 10 million new Polish zloty (PLN) and a staff of about 15 employees. Two years later, the Polish fashion clothing market changed with the opening of the country's first hypermarkets. These retail outlets sold everything and needed many suppliers. An opportunity had been created, and Piechocki and his partner did not let it get away. They ended up selling to small stores, hypermarkets and wholesalers, as well as selling products directly to large companies (caps and promotional apparel). Around 1996 they started to export to neighboring countries, working through exclusive importer-distributors.

But the honeymoon with their best clients was not to last. They knew their business model would end up being copied, just as their first idea had been. Faced with this prospect, in 1999 they opened their first store in Szczecin. In 2001 they stopped selling to small retailers. In 2002 they also stopped selling to wholesalers, who were succumbing to the competitive pressure exerted by hypermarkets. And finally, in 2003, they stopped selling to the hypermarkets, which had become increasingly demanding, making it difficult to achieve profitable sales.

The path to growth

By 2001, LPP had 15 of its own stores under the Reserved brand or trade name, and prospects for strong growth. The company needed financing because each new outlet took about 18 months to become profitable. Piechocki and his partner opted to turn to the stock exchange on two occasions.

Two capital increases brought LPP approximately PLN 60 million for 68 percent of its equity. Piechocki and Lubianiec reserved 32 percent of the capital stock, partially in the form of preferred stock, with five votes per share, in order to ensure that they retained control of the company.

LPP continued to open new stores. From 2002, stores were also opened abroad. Existing stores were expanded, and new chains were launched - Cropp in 2003 and Esotiq in 2005. At the same time, LPP segmented its product range and optimized internal processes. LPP had reached a point at which it could compete with leading companies like Inditex and H&M.

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The growth of LPP was largely dependent on several factors: not only its ability to attract and satisfy end customers in its stores and other commercial and financial factors, but also its skill in negotiating leases on good terms for outlets in the new malls that international property developers were building in the countries of Central and Eastern Europe.

Should LPP buy another chain?

In early 2008, the market for affordable fast-fashion apparel in Central and Eastern Europe was still growing. LPP brands continued to grow at a somewhat faster rate than the market as a whole. Nevertheless, it was very difficult to open a new fashion chain, and the best premises were already occupied.

Asian suppliers, the most competitive, only accepted orders for a minimum of 1,000 pieces per model, which was beyond the reach of a new chain with perhaps just five stores. This situation led Piechocki and his management team to consider buying one or more rival retail chains. Their attention was drawn to Artman.

The company owned House, an interesting brand with some 190 stores. However, it was not clear that the purchase was a good move: The brand was profitable but only generated a 4.5 percent return on sales, far short of the 10.5 percent achieved by LPP. Lacking a more detailed analysis, Piechocki and his executives focused on the elements that would be most difficult to change in the short term:

- Artman paid competitive rent on its premises, so this did not explain its low profitability.
- The stores were in good locations.
- Their appearance and surface area were considered acceptable.
- The brand had a good image and was well recognized.

At first glance, Artman's lower level of profitability appeared to be due to internal problems or inefficiencies. LPP believed the figures could be improved if its IT, warehousing and logistics systems were applied. Moreover, the new company would be in a stronger negotiating position with regard to the owners of new fashion malls, suppliers and franchise partners. Labor costs could also be improved by integrating some departments in the LPP structure.

In 2007, Artman made a profit of PLN 11 million. LPP executives estimated that if Artman was acquired by LPP, its net profit could reach PLN 50 million in 2010, but this was just an estimate.

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LPP had earned a profit of PLN 135 million in the 2007 fiscal year, a much better result than preceding years. The acquisition would cost PLN 400 million, with a substantial premium of 50 percent over the company?s stock market value ? a lot of money for a purchase that was not absolutely necessary.

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