

Abercrombie and fitch: international expansion external and internal analysis ess...

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International expansion external and internal analysis

This case study was identified to examine why international sales volume of Abercrombie and Fitch have increased over the past three years and to recommend further international expansion to increase sales volume. The research draws attention to the fact that in 2009, the US stores generated 81. 2% of Abercrombie and Fitch's net sales. The shares of international stores and direct-to-consumer net sales were very small in comparison. Over the next two years the US stores decreased net sales percentages while net sales increased. Further investigation reveal that the US market shrinkage in terms of overall company net sales percentage coincided with the increase in international sales and direct-to-consumer sales and the overall company net sales percentage over the same time period. Since the economic downturn in the US economy in 2008 the disposable income for Abercrombie and Fitch clients appeared to decrease. Additionally individuals were utilizing disposable income for other items such as technology, cell phones and other gadgets. These two items appeared to be the major causes of the decreased company percentage in net sales of Abercrombie and Fitch in the US.

During the same two year period the international stores and direct-to-consumer net sales increased dramatically. This was an increase of 342% for international stores and 190% for direct-to-consumer sales over the same two year period. Abercrombie and Fitch have identified that international expansion is the key to the company's success. The case study evaluates the economic situation within the European union and its effects on the global economy and identifies the impacts on the retail industry risks, specifically

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for Abercrombie and Fitch. All current financials and ratios can be found in the appendices. Results of the data show that expansion of international stores and direct-to-consumer initiatives have had a very substantial financial impact on net sales. In particular to note is the 342% in net sales from international sales. The case study also finds that these numbers being very good the economic situation for Abercrombie and Fitch is not positive for international expansion. The major areas for international expansion will require further investigation and due diligence action by senior management. Recommendations discussed include: Increasing direct-to-consumer capabilities and increasing due diligence for potential international expansion markets. Table of Contents

Introduction

Abercrombie and Fitch and its brands are a group of specialized apparel stores that target a specific niche market that makes customers feel young, sexy, appealing and part of the “in crowd”. The individuals that are lured by the various Abercrombie and Fitch brand stores, like Abercrombie and Fitch or Hilly, are because of the store’s image appeal. Upon entering these brand stores there are beautiful young adults greeting you at the door presenting an image that is extremely appealing and wanted by many within these varying age groups. Abercrombie and Fitch was founded in 1892 as a supplier of sporting and excursion goods. The founding fathers of Abercrombie and Fitch were David Abercrombie and Ezra Fitch with the original store located in New York. As time has passed ownership of Abercrombie and Fitch have changed multiple times up until its incorporation

in 1996. Currently Abercrombie and Fitch is a retailer of casual and informal clothing as well as accessories through retail brick and mortar stores as well as direct-to-consumer operations. Abercrombie and Fitch offer a broad array of clothing options and accessories through 4 distinct operations:

Abercrombie and Fitch, abercrombie kids, Hollister and Gilly Hicks.

The company is headquartered in New Albany, Ohio with over 1000 stores in North America, European union and Asia and \$4. 1 Billion in net sales. The organization has approximately 85, 000 associates including part-time. 1 2 3 In 2006 Abercrombie and Fitch launched the initial international expansion with the opening of the London, England store. From that initial launch the company has successfully launched other international locations in Milan, Italy and Tokyo, Japan as well as other locations in European union and Asia. In addition to these brick and mortar operations, Abercrombie and Fitch have expanded its international reach with its online store capability.

External Environment – General

Political

Any organization expanding its operations internationally faces a number of political factors including: Government and tax guidelines, employment regulations, environmental regulations, trade and tariff regulations and limitations, as well as other factors. Organizations that operate internationally need to review and ensure that free trade agreements are in place for easier transfer of materials for the purpose of manufacturing as well as the distribution of the final inventory for end sales. The majority of clothing manufacturing resides within Asia, Central America and South

America. In these regions there are risks associated with deregulation of political initiatives that could directly affect any vendors that are used for supply chain management. 4 Any changes politically can cause disruptions in trade to many of these other countries. This type of risk could directly affect inventory and logistics, as well as lead to lost sales and increasing standing inventory costs. The industry is also subject to the labour training laws of the country of operations and these organizations may require modifying current practices as well as increasing costs or having a negative impact to company reputation with non-compliance. The risks can be considered moderate to high as any employee, supplier or vendor having circumvented the labour training laws would be associated with the organization.

This could impact the way business is conducted and could increase costs of merchandise, and may also impact manufacturing and logistics as well as potential fines, penalties and reputation issues that may arise. 5 In addition with the current financial situation within numerous countries (Greece, Italy, and Spain) there have been sweeping changes in taxation laws both for individuals and business in order to stabilize economic conditions. These potential changes have a high risk to the financial situation of any regional brick and mortar operation as there is a definite impact to the organization's gross profit margins.

Economics/Global

Basic economics identifies a recession by contracting GDP and increasing unemployment. Currently in the European union there is a general fall in GDP and rise in unemployment. Greece, Spain and Portugal have been

especially hit hard with high unemployment. This contracting GDP also has impacts on workers, as some workers will have wages lowered and some will have the hours reduced. Each of these measures is used by organizations to reduce costs while attempting to maintain an adequate workforce. 6 7 The result of contracting GDP is lower amounts of disposable income for the purchase of non-essential items. 8 Abercrombie and Fitch and brands are dependent on the consumer demand of its market niche. With consumer demand being the driving force behind the success in the various markets, demand is based on consumer purchases of these discretionary items. Discretionary purchases are adversely affected during any recessionary periods or other worldwide economic conditions. Reviewing the financial summary (Appendix B), from 2009 to 2011, it is evident that the closure of RUEHL Branded stores and the associated Direct-to-consumer operations had a significant impact in 2009 as identified in the Net Income.

The impact of the downturn in the US also had an impact in 2009 and 2010 as the net sales percentages in the US dropped in comparison to the international stores and direct-to-consumer percentages which was due to the economic downturn in the US as Abercrombie and Fitch have the significant amount of its operations in the US market. 9 10 In contrast the international market stores and direct-to-consumer have increased the net sales with staggering results. (Appendix A) In addition to the increased percentages identified for each part of the organization, there is the review of percentage of overall sales, which have seen significant increases in both international stores and direct-to-consumer which are showing year over

year increases. These results cannot identify how the downturn in the US economy affected the financials, where an impending downturn in the European union can potentially have similar effects. There are a number of reports indicating regional economic and labour market developments based on the impacts that are occurring politically and economically in the global arena and the potential effects. 11 Inflation can be seen as high risk for Abercrombie and Fitch. Many countries such as Greece, Italy, Portugal and Spain now have to borrow from the European union at unheard of interest rates in order to get the country back in control. The European union fund for financial stability has now put a number of other countries in tedious times as this fund is completely funded by member countries.

Recent recession identifiers in Britain show a trade deficit which is nothing abnormal with the European union financial crisis in its current state. In the case of Britain it is on the verge of matching Japan's lost decade in which the country's GDP is flat lining or contracting. This type of trade deficit continues to put a strain on potential international expansion as the launch capital needed is high, and the short term revenue numbers may not be available without disposable income. 12 13 As the economic crisis increases in the European union there are many countries in deep crisis where the Euro is falling in comparison to the dollar. Depending on the stability of these individual countries and its part within the European union, the tax rates may need to be increased to both the public as well as corporations. The additional costs that will be incurred to be fully versed in each of the regional

and national tax laws will also be substantial and may require 3rd party subject matter experts.

14 There is also the impact on exchange rates, as well as other triggers throughout the European union. The varying triggers can affect local currency in comparison to the USD, as the corporate currency of Abercrombie and Fitch is stated in USD, where individual international subsidiaries are generally functioning in the local currency. All financial records are translated into USD from the varying exchange rates at the point of reporting or at the end of a specified reporting period. 15 The end result is the fluctuation in the USD against all other currencies may have a positive or negative impact on the financial reporting results. Sociocultural

Abercrombie and Fitch is among a small group of international companies that have increased the number of women in senior executive roles as identified by Diane Change - Executive Vice President - Sourcing; Leslee K. Herro - Executive Vice President - Planning and Allocation; These two women represent an increase in percentage of the senior executive team for Abercrombie and Fitch. This is significant as currently in the European union business market women only represent about 14% of board members.

This positions Abercrombie and Fitch in a leadership position in which women being able to advance within the organization, in addition to studies being promoted today in which increased number of women in senior positions has also lead to increased company financial performances. 16 17 Public demand also dictates that the increasing of women in these senior positions is a very high concern. This positions Abercrombie and Fitch in a very positive light for

European union expansion. Abercrombie and Fitch have also increased its workplace diversity as well as incorporated the development of diversity into the corporate strategy.

In 2004 Abercrombie and Fitch were sued for discrimination, but have now turned that into a strength of the organization with the introduction of the Abercrombie & Fitch Co. Charter of the Corporate Social Responsibility. 18 The diversity in the workforce began with the appointment of Todd Corley as VP of Diversity and Inclusion. This appointment drove the corporate strategy forward throughout the Abercrombie and Fitch corporate culture. 19 The workforce diversity within Abercrombie and Fitch is constantly monitored and action plans are continuously changing based on the numbers for diversity that are in place. These numbers are continuously monitored and audited and are followed up through all levels of the organization. 20 This type of strategy will limit any risks for international expansion as the strategy of diversity will take into account the regional diversity and adapt it to the store within the region. The operations for Abercrombie and Fitch will be affected by concerns about the environment. These risks are medium to high, as the European union Commission has proposed a new Environment Action Programme for the European union. The Abercrombie & Fitch Co. Charter of the Corporate Social Responsibility will also have a focus on the environment to reduce this risk as well as increase the global reputation. 21 Technological

With the increased competition within the retail garment market, Abercrombie and Fitch needs to ensure a quick to market approach of new fashions and trends as the market dictates. In addition to the market,

Abercrombie and Fitch need to ensure that the organization remains a leading fashion dictator, and innovate within this niche to maintain and attract clientele to the company's brands. 22 The risk of being a leader in the market and design poses a number of issues if clientele do not take to the new trends or outright rejects them. The potential for outdated inventory, the cost of manufacturing and logistics and lost sales is a potential.

Abercrombie and Fitch rely on the experience and skill of its senior executive team. The loss of this team or members of this team could affect the business in a very negative manner. These members work very closely on all aspects of the Abercrombie and Fitch operations. The executive team's experience in the retail industry has positioned Abercrombie and Fitch in a very good position for today and the future.

However with any potential changes and without any succession plans in the case for a senior member leaving, the business and operations could be adversely affected. In addition to the costs that would be incurred for buying out these executives would be substantial. 23 When dealing with technologies there are two aspects that need to be reviewed. Changes and upgrades to information technology; &

Personal identifiable information within technology;

These systems have varying degree of risk as well as impact to the operations. Abercrombie and Fitch continuously evaluate the current information technology systems that support the business operations. These include any upgrades to software, hardware and infrastructure to existing systems as well as complete replacement with successor systems.

Abercrombie and Fitch need to be diligent with the change management process for any upgrades or new systems. The change management process can mitigate any risks with diligence in a much disciplined methodology that incorporates senior management messaging, program management, testing, and user involvement and acceptance. The risk of not adhering to a disciplined methodology can result in system disruptions as well as data inaccuracies. If these risks are not mitigated and planned for there can be adverse effects to manufacturing, logistics, operations and financials as these systems are integrated throughout the entire organization. 24 25

Demographic

The population size for Abercrombie and Fitch is every child 7-14 for abercrombie kids, and 18-22 year old for all the other brands under the Abercrombie and Fitch umbrella. In addition to these age groups the allure of the product and to feel young and sexy, it adds kids 14-18 who want to feel older and sexy, as well as the post 23 year olds to feel younger and sexy. This population size will vary from country to country, and as part of the international expansion research it is necessary to determine two key populations: Within age range - the market for Abercrombie and Fitch is individuals within these age ranges, as these are the individuals who the clothes and accessories are marketed towards; and Parents of individuals within age range - the disposable income of the individuals within the age ranges are limited; the disposable income of the parents is very much higher. Focusing on both populations, allows Abercrombie and Fitch to market its message as well as keep prices higher as a unique brand, which

for certain parents is something that these individuals may not have had when they were young. The geographic distribution of the demographics for Abercrombie and Fitch is mainly the US; however expansion into the international markets has increased the geographic distribution. In addition, with the online offering by Abercrombie and Fitch the population exposure to the varied brands increases dramatically as the population no longer needs direct access to one of the current locations, but simply an internet connection, a secure ordering process and a mailbox to get the product delivered.

26 Abercrombie and Fitch have introduced a “if you really knew me...” initiative that creates an inclusive environment for in-store associates and customers based on those themes and the ethnic mix. 27 This has allowed Abercrombie and Fitch to provide a young and sexy image to all ethnicities globally. Abercrombie and Fitch have always portrayed its brand as exclusive and as such as priced its products accordingly. There are no product sale initiatives or discounting as the brand is based on an image, and a price needs to be paid for that image. With this strategy the Income distribution for the Abercrombie and Fitch policy is of privilege.

External Environment – Industry

Porter’s Five Forces

Threat of new entrants

The threat of new entrants into the Abercrombie and Fitch market are estimated weak to medium risk. With the retail garment market being

profitable, there will always be attempts by new groups to gain access into the market, however the capital needs, and costs associated entering the retail clothing market are significant. In reviewing Abercrombie and Fitch's financial statements, specifically the costs of goods sold as well as total stores and distribution expense, it is easy to recognize that capital needs in order to be considered successful within this market. (Appendix B) With Abercrombie and Fitch already being established within the industry as well as the competition, it becomes increasingly difficult for new entrants to have any significant impact within the market. The power of suppliers

The forces associated with the power of suppliers is considered moderate and any type of delays from Abercrombie and Fitch's key vendors as well as manufacturers have the ability to affect the supply chain. Any adverse effects to the supply chain can potentially result in delay to market, lost sales and potentially increased delivery costs. Abercrombie and Fitch currently utilize 170 vendors outside of the United States, primarily located in Asia, Central America and South America. 28 29 The power of buyers

The forces associated with the power of the buyers are considered moderate. Abercrombie and Fitch have identified the company's niche in the market as the 18-22 year olds. This demographic are the buyers, in which they are manipulated by the image of youth and sexiness. These buyers will spend their discretionary income on popularity. These buyers have much more purchasing power, so the issue will be how to entice these buyers to purchase these items from Abercrombie and Fitch. 30 Product substitutes

The retail clothing industries have a number of competitors in various niche markets, and it is no different for Abercrombie and Fitch. The biggest competitors for Abercrombie and Fitch include American Eagle and The Gap. These specific retailers produce and manufacture similar products with similar price ranges. In addition to the major rivalries there will also be local, regional and national competitors that will attempt to come into the market as the retail market is substantially large. There will always be substitutes that will try to gain leverage in the marketplace, Abercrombie and Fitch will need to adhere to its products and market and not deviate from its image. In the international expansion arena, this image is what people are buying. Abercrombie and Fitch will need to adopt a few policies to face challenges from these competitors as well as any regional and national competitors coming into the market. 31 32 The intensity of rivalry among competitors

Abercrombie and Fitch will need to adopt a few policies to face challenges from these competitors as well as any regional and national competitors coming into the market. The Abercrombie and Fitch product team needs to ensure fashion team is on the leading edge of fashion design. In addition to leading, this part of the company must be adept and modifying based on consumer wants and needs. This adaption process needs to be fluid to ensure manufacturing and logistics can get new product to market in a very timely manner. The marketing group needs to have initiatives that drive the Abercrombie and Fitch name and products. Create that brand recognition that will drive product and name recognition. In addition counter any competitor marketing initiatives with aggressive marketing that identifies the

Abercrombie and Fitch brands as exceptional and unbeatable. All aspects of the organization are part of the brand recognition, and with increased competition it is important that Abercrombie and Fitch maintain its competitive advantage which is the company's product image. This image is what differentiates Abercrombie and Fitch from the competition and positions the company in a good position for international expansion. 33 34

35 Porter's Value Chain

Inbound Logistics

In 2011, Abercrombie and Fitch used approximately 170 vendor located across the world to manufacture the various Abercrombie and Fitch product lines. These vendors are located in 17 countries including the United States.

36 Operations

The operational component to Abercrombie and Fitch consists of a global sourcing strategy that ensures that no single vendor will manufacture more than 10% of its merchandise. Each vendor also must achieve and maintain the company's high quality standards, which are an integral part of the company's identity. All sources involved with operations must adhere to these high standards, and Abercrombie and Fitch assign home and field employees to monitor operations to ensure the company's product quality standards are maintained. As a preventative measure prior to any production for new vendors or factories, the factory, contractors, sub-contractors and any employees must adhere to the code of conduct and are audited for adherence. Finally, there is a yearly audit conducted to ensure continuing adherence. 37 Outbound Logistics

All outbound logistics are handled through the companies two distribution centers in New Albany, Ohio. There is also a third party distribution center in the Netherlands for customers and stores in European union as well as a distribution center in Hong Kong for customers and stores in Asia. The organization utilizes two third party shippers to ship product: one shipper ships to North American stores and direct to client, with the other shipper shipping to European union and Asian stores as well as direct to client. The stores and distribution centers maintain enough inventories to ensure customers are offered a full selection of current offerings. In addition inventory is monitored using an inventory management system that identifies current store and distribution center inventory, and will order additional stock once lower limits are met. 38 39 Marketing and sales

Abercrombie and Fitch uses it's in store experience as the primary marketing approach. The idea is that the in store experience is about an image and lifestyle that is represented by each brand. All the senses are used to portray this image and lifestyle. In addition to the in store experience, the same image and lifestyle is portrayed via internet channels as well as social media. This image in association with public perception and word of mouth has placed Abercrombie and Fitch in a strong position without the need of expensive marketing and advertising campaigns. 40 Service

Abercrombie and Fitch provide a lifestyle service. Upon entering the stores the individual is transformed into a vibrant young sexy surrounding. This service provides the user experience that many consumers not only strive for, but want to have and maintain. This lifestyle service is enhanced by the

products offered for each of the brands and the senses. This service in conjunction with the products is offered with a premium price as these lifestyles are identified as not for everyone, only the privileged young and sexy individuals. 41 Procurement

Abercrombie and Fitch will continuously have to deal with material costs as cotton is a commodity and will fluctuate with the market. 42 Technological Development With the increase in internet shopping the security and features of the Abercrombie and Fitch direct-to-consumer user experience will continue to expand and be essential. With increases in internet access and speed as well as the security for on line shopping, it will create a direct-to-consumer avenue that will reduce a number of store costs and will deliver the Abercrombie and Fitch product to clients. Human Resource Management

Abercrombie and Fitch offer two very different types of employment: There are the in-store opportunities that incur very low costs in training as most of these employees are either part time or seasonal. With most of the employees at the sales rep level there is little hands on training. There is also the model employment for the in-store experience. For both of these roles, there is an employment handbook of look and etiquette. There are also the management/leadership opportunities that incur much higher costs as the training is extensive and comprehensive and involves the running of the business. With Abercrombie and Fitch hiring mostly from within the organization it is through this management/leadership program that continuing careers materialize. 43 Firm Infrastructure

Abercrombie and Fitch is a clothing manufacturer without a factory as the production of the goods is separate from the design as well as the sales & marketing. The internationalization of Abercrombie and Fitch will include outsourcing of a number of activities and also setting up a lower cost production network. Becoming globalized will be about creating a better business model which includes finding better ways to source, creating or identifying new market segments, working with third party firms and creating innovation within the marketplace. 44 45 Strengths

Conclusions

Abercrombie and Fitch should have two avenues to international expansion: E-Commerce - The e-commerce portion of the company should be expanded with a focus on social media and search engine optimization. This endeavour would enable Abercrombie and Fitch to expand its reach to international markets not available in the past. In addition it would allow Abercrombie and Fitch to determine potential markets and demographics for expansion to brick & mortar stores. Brick & Mortar - The international expansion of this portion of the business should be moved forward cautiously. As evidenced with the decline in profits with the US recession there is a great risk with the current European union monetary issues and the potential for global recession. There continues to be many untapped markets that Abercrombie and Fitch can enter, it is important that due diligence is completed and analyzed to determine market availability. A number of regional economies that may be reviewed include Russia, India etc. These markets appear attractive as potential regions as these regions have a large population base,

and specifically contain a significant population within the Abercrombie and Fitch target demographic. Each of these types of potential markets should be reviewed to determine current e-Commerce markets for the potential of placing a test store within the market to determine future expansion. All aspects of entering a new region including economics, politics, sociocultural etc. need to be reviewed carefully as the start-up costs of a new region are extensive. Upon full review and test marketing the process to open and market a new region would begin. The company needs to focus its future strategy on continuing to expand into select foreign markets using both e-commerce and brick & mortar stores. With success in these two areas Abercrombie and Fitch will continue to grow the organization's market share and maximize the wealth of the shareholders.