Doing retail differently

Private equity firms are looking at experientiality and brand affinity to connect with consumers and capture future spend, writes Carmela Mendoza

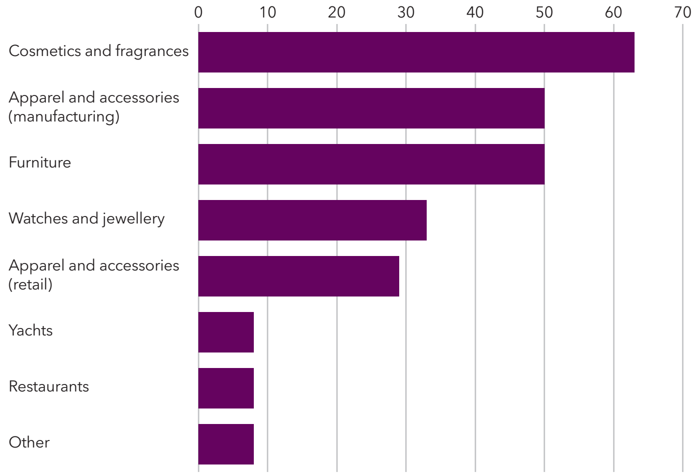
Private equity's interest in the consumer space remains strong despite macroeconomic conditions affecting consumer spending. Portfolio companies have also been resilient to rising inflation over the past two years by adopting pricing and value chain strategies to offset cost increases.

That being said, the consumer market faces relentless winds that change direction every week, according to Nicolas Chavanne, managing director and head of retail, consumer and leisure in Europe at Advent International. The economic reality of rising interest rates, consumer activism and behavioural changes in consumption and technology are weighing on the industry, he notes.

"With supply-chain inflation, companies took action on pricing to preserve margins," he says. "This needs to be explained to customers… If you don't give value for money, they will do some arbitrage between brands or between categories, and that's what you want to avoid."

Among Advent's latest acquisitions in the consumer space are Australian fashion brand Zimmermann and niche fragrance brands Parfums de Marly and Initio Parfums Privés. The firm has been investing in the retail, consumer and leisure sectors for more than 30 years and has completed around 85 investments globally, according to its website.

Most attractive consumer sectors for investors (%)



Source: Deloitte

"The key element for us in our investments is to minimise risk and how much due diligence we've done to do that," Chavanne says. "We want to underwrite investment opportunities with multiple growth levels and want to get comfortable on the baseline. We're underwriting a business plan today, but we want to make sure that the next owner will have a very interesting story in five to six years."

Chavanne notes that the granularity of consumer surveys has expanded and depends on the brand that consumers are buying, as well as the level of maturity of the brand in each geography. "I think it's important today to understand your consumers not just in terms of income distribution, but also brand affinity. They always have a choice at the end of the day."

André Puong, a partner at Cathay Capital, adds that it is tougher for sellers or businesses raising capital to convince investors about the macroeconomic outlook and their business plan. "It has gotten harder for investors to track the changes in consumer behaviour, and at the same time meet eye to eye with company owners on earnings projections."

As such, the Paris-headquartered firm – owner of Canadian luxury outerwear brand Moose Knuckles and perfume brand Juliette Has a Gun – is spending more time with companies that have stronger tailwinds to "read through the noise of these up and downs", says Puong.

A new phase

Investor sentiment towards fashion and luxury assets remains positive. A Deloitte survey of senior sector specialists within private equity funds found that at least 80 percent are still investing in the sector in 2023. Cosmetics and fragrances was the most popular category at 63 percent, followed equally by apparel and accessories manufacturing, and furniture (both at 50 percent), while watches and jewellery came in fourth (33 percent).

Along with sustainability and ESG, and digitalisation, the functional and symbolic value of goods is a key trend affecting the luxury market in 2023, according to the report: "The importance of visible functional benefits, such as brand heritage, craftsmanship and longevity, as well as improving brand communications, narrative and experience, are being increasingly emphasised by businesses as customers adopt a more mindful approach to luxury."

Puong notes that consumers continue to be attracted to brands that offer a combination of product quality and brand values that matter to customers. "There is a trend about wanting products that 'speak to my values'. As such, brands have also stepped up in terms of being able to speak to those consumers on more of an individual level through curation, social media and data. This means better data crunching and better understanding of consumer behaviours and trends through ever increasing use of data."

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Niche appeal

Firms are also capitalising on the direct-to-consumer trend. A June 2023 consumer survey from PwC found that a majority of consumers (63 percent) have purchased products directly from a brand's website. Nearly 30 percent said that although they haven't done so yet, they are considering the D2C option.

"A lot of multi-brand retailers do curation, but a lot of younger consumers also go direct to the brands," says Puong. "Newer brands today speak to a younger, more diverse and open-minded demographic."

The authenticity of products, particularly when consumers are shopping for clothing, electronics, and beauty and personal care items, is the main draw to D2C websites, according to the PwC study. Consumers also cited greater choice of products, competitive pricing and better availability of stock in D2C purchases.

As well as premium fashion, niche fragrances appeal to the younger generation and have gained a lot of market share over the last five years, says Chavanne. "It's a trend that's going to stay because there has been a shift in behaviours. If you look at the penetration rate of fragrances in the US, it's only 20 percent compared to 50 percent in Europe. In Asia, it's very low… Over the next 10 years, we see an amazing avenue to grow niche fragrances.

"There is a need for individualisation as well today that needs to be addressed. For fragrances, the entry price point is still relatively low compared to fashion. It's a great entry point to the consumer sector today."

According to an analysis by Bain & Co, the market for personal luxury goods is expected to grow from €360 billion in 2023 to between €530 billion and €570 billion by 2030. Even in spite of slower economic growth and high inflation, the market opportunity here is significant. ■