

Stronger Dollar: A Boon and a Curse

by WWD Staff

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The euro has been heading downhill for the better part of this year.

Photo By Illustration by Tyler Resty

LONDON — The dollar is bulking up — and that's cause for either cries of pain or celebration.

The euro has fallen 11.3 percent against the dollar year-over-year while the pound has slid 9.4 percent against the U.S. currency. The renewed strength of the dollar will have an increasing impact on the bottom lines of retailers and brands that source and manufacture in greenbacks, while giving American companies renewed muscle in the European market in terms of buying everything from designer goods to other companies.

On an even more personal note, the heftier dollar will mean all those buyers and journalists who relocated to the Hotel Jolly during European collections season might now be able to return to the Park Hyatt — and no longer have to pay \$10 for a Coke.

But while the stronger dollar will beef up the buying budgets of American retailers during the upcoming season of men's and women's fashion shows, industry analysts say the European firms most vulnerable to the stronger dollar are small-scale operations and discount chains that source and manufacture in the Far East and trade in their local markets. By contrast, large brands and retailers with broad international exposure have already begun to reap benefits from the current fluctuations. Almost all Far Eastern sourcing is denominated in dollars.

"Consumer confidence in Britain is already bombed out, and the currency impact will be yet another blow to retailers — one that is beyond their control," said Nick Hood, partner at Begbies Traynor Group, the London-based business consultancy and insolvency practitioners. "The consumer will not put up with price rises."

But U.K. retailers are already increasing prices: It's been widely reported here that big retail chains, such as Marks & Spencer, Debenhams and Primark, are planning to raise prices by between 4 to 8 percent to compensate for higher cotton

and silk prices, rising labor costs in the Far East and the currency pinch. Raw materials prices were skyrocketing even before the crisis in the Greek economy sent the euro plummeting, and the weakened currency will only exacerbate the problem.

Nor do those price hikes take into account a widely expected increase in Britain's value-added tax to 20 percent from the current 17.5 percent later this year.

"The real pressure on prices will come in the autumn, and the discount and value chains will be most affected because they have less margin to play with," said Don Williams, head of retail at BDO LLP, which tracks monthly sales figures on the U.K. high street and online.

Williams added that hedging — or buying currency in advance at favorable exchange rates — is merely a palliative: "All hedging does is ease the pain over a period of time. At some level, every retailer will have to deal with the impact of the fall in the euro and pound."

For the moment, though, retailers and brands in the Eurozone are holding their nerve — and looking for new solutions to current financial problems.

"Everyone expects the weak euro to be accompanied by the danger of higher retail prices because of more expensive imports and rising energy costs," said a spokesman for the German Retailers' Association. "But we're very far from that at the moment because companies and manufacturers could hedge — as they always do. They are also trying to develop defensive strategies, such as geographically shifting sourcing."

He went on to say that, in Germany's highly competitive retail environment, higher sourcing and manufacturing costs cannot simply be passed on to the consumer. "They wouldn't stand for it," he added.

Nils Vinge, head of investor relations at Hennes & Mauritz, said the company, which sources about two-thirds of its merchandise in Asia, is expecting to see higher production costs in the short term.

"However, there are many factors that affect the costs and prices besides currency. Most important is that we stick to the business idea and that we focus on offering the customer a good deal, regardless of the currency fluctuations," he said.

Vinge declined to comment specifically on the company's future pricing policy. "The customer should always be able to make a good deal at H&M," he said.

While luxury companies likely will be less impacted by the weaker pound and euro — they have broad international exposure and tend to source and manufacture in the Eurozone — even their principals admit they're not immune to the currency roller coaster.

"For a company like Versace that essentially produces in euro but exports a significant part of its production, we expect short-term benefits," said Giangiacomo Ferraris, chief executive officer of Versace. "That said, a weaker euro will bring an increase of raw and primary materials such as gas and oil with an evident impact on everything."

On a more upbeat note, Ferraris added for countries such as Italy that export a lot, the weaker euro makes locally produced products more competitive and offers companies the chance to increase market share abroad.

Mary-Adair Macaire, ceo of Pringle, would agree. She said the brand sources most of its raw materials in Scotland and Europe. "The weakening euro is actually of benefit, and helps our U.K. [flagships] immensely with tourism trade," she said.

In the year ending March 31, Burberry's revenues got a 65 million pound, or \$95 million, bounce due to fluctuating exchange rates. In the past, Burberry has suffered from the strength of the pound against the dollar and euro.

Stacey Cartwright, Burberry's chief financial officer, said the company has a natural hedge with regard to European sales, as much of its sourcing and manufacturing take place in the Eurozone. Only about 10 percent of Burberry's manufacturing is done in dollars.

She said that, going forward, Burberry would most certainly be "subject to the vagaries of currency fluctuations," and that it was up to the supply chain team to negotiate with suppliers to offset any future negative impact from currency.

Richard Lepeu, deputy ceo of Compagnie Financière Richemont, parent of companies including Cartier and Dunhill, said the Asia-Pacific business is mainly dollar related, "and that will work in our favor overall. It means we won't be forced to increase prices in those regions."

With regard to the euro weakness in other regions, Richemont's cfo Gary Saage said the weak euro would have a beneficial impact in the short term.

At Hugo Boss, the weakness of the euro against the dollar is expected to positively impact the German apparel group's profit, according to cfo Mark Langer. While Langer couldn't quantify the effect, he noted Boss generates more revenue in dollars and dollar-connected currencies than it needs to spend on sourcing.

Boss usually hedges against fluctuations of the dollar, pound and Swiss franc. Langer said the group has hedged as much as 70 percent of its expenses in these currencies for the coming 18 months.

Gianluca Brozzetti, ceo of Roberto Cavalli Group, said although his company's sourcing is mainly in Europe, he's already thinking of ways to bring prices down in this uncertain climate.

"You can still have luxury [while] not necessarily spending crazy money. You have to work with the pipeline to challenge every single step, and you have to create with the retail price in mind," he said on the sidelines of the Walpole 2010 Luxury Forum here last week.

Brozzetti said he is looking to overseas expansion in the long term. "We're looking to the U.S., and Asia is an open page... but there's a lot to be done." he said.

Like Brozzetti, Issa's ceo Mark Abegg is taking the currency crisis in his stride. "The key is to reallocate sales made in dollars to our cost base in dollars," he said, adding that about 20 percent of Issa's sales are in U.S. currency and most production is done in Asia in dollars.

Don Williams, head of retail at BDO in London, said only certain companies — those that export internationally — have Issa's "natural hedging" mechanisms.

"Independent retailers — and one-store operators — will suffer the most because they will be under pressure from suppliers," he said.

"Any retailer with fewer than 15 stores doesn't have the power or the flexibility to haggle with the landlords or the banks right now," he said. "And the big players in the retail supply chain are increasingly pressurizing and bullying their clients. Everybody is out to protect themselves."