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J.Crew's Mickey Drexler Confesses: I Underestimated How Tech Would Upend Retail

Retail legend didn't understand how speed and price would drive internet shoppers; 10 quarters of falling sales



J.Crew CEO Mickey Drexler, center, is refocusing on lower prices and a more accessible image. The company said last month it was parting ways with creative chief Jenna Lyons, in pink. PHOTO: SAM DEITCH/BFA

By Khadeeja Safdar

Updated May 24, 2017 11:17 a.m. ET

Millard “Mickey” Drexler, the fashion genius whose ability to spot trends reshaped how Americans dress, has a humbling admission. He missed what might be the biggest trend of all—how quickly technology would change the retail industry.

“I’ve never seen the speed of change as it is today,” the 72-year-old chairman and chief executive of J.Crew Group Inc. said in an interview at his New York office. “If I could go back 10 years, I might have done some things earlier.”

The retail veteran, who redefined Gap Inc. in the 1990s and then transformed J.Crew into a household name, is now scrambling to keep the company he took private in a leveraged buyout from ending up in bankruptcy.

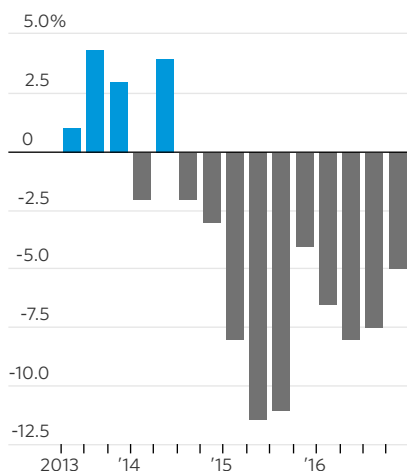
Sales at J.Crew Group stores open at least a year have fallen for the past 10 quarters—the kind of slump that got Mr. Drexler ousted from the Gap in 2002. This time he owns 10% of the company, and it is lenders, not the founding family, that are putting on the pressure.

For decades, fashion was essentially a hit or miss business. Merchants like Mr. Drexler would make bets on what people would be wearing a year in advance, since that’s how long it took to design and produce items. Hits guaranteed handsome returns until the next season.

Now, competitors with high-tech, data-driven supply chains can copy styles faster and move them into stores in a matter of weeks. Online marketplaces drive down prices, and design details such as nicer buttons and richer colors are less apparent on the internet. Social media adds fuel to the style churn—consumers want a new outfit for every Instagram post.

Latest Trend

J.Crew Group's same-store sales have declined for 10 straight quarters; change from a year earlier



Source: company filings
THE WALL STREET JOURNAL

“The rules of the game have changed,” said Janet Kloppenburg, president of JJK Research, a retail-focused research firm. “It’s not just about product anymore. It’s also about speed and pricing.”

Mr. Drexler’s plan is to emphasize lower prices, pivot toward more digital marketing and adopt a more accessible image. “We became a little too elitist in our attitude,” he said.

Many visionaries focus on doing what they do best, even when the ground shifts beneath them. From newspapers to television, successful companies have been upended by disruptive technologies. Facebook Inc. is now the world’s largest publisher; Netflix Inc. is worth twice as much as CBS Corp.

“The incumbent leaders never see it coming,” said Clayton Christensen, the Harvard

Business School professor who introduced the theory of disruptive innovation 20 years ago. “They focus on their best customers and try to provide what they need, but the customers who first defect [to new technology] are usually the least profitable.”



Mr. Drexler said J.Crew gave a perception of being higher priced than it was. Above, performer Sandra Bernhard poses in J.Crew at New York Fashion Week in February. PHOTO: BRIAN ACH/GETTY IMAGES

Mr. Drexler, known as the “merchant prince,” built some of America’s most recognizable apparel brands, including Old Navy, Banana Republic and most recently Madewell. He focused on details such as the feel of the fabric, the weight of the buttons and the plaid inside waistbands, according to former executives who worked with him at J.Crew and Gap. Higher quality allowed J.Crew to charge a premium for its casual, preppy styles.

The New York City native, who doesn’t have his own Instagram, Facebook or Twitter account, was sharing thoughts with employees on a loudspeaker—hooked up through his phone—before Twitter was launched. He paid attention to firsthand shopper feedback on frequent visits to stores long before Amazon.com Inc. was collecting user data. He was also selling clothes online before many other specialty retailers. Nearly half of J.Crew’s sales now come from the web.

But Mr. Drexler didn’t appreciate how the quality of garments could easily get lost in a sea of options online, where prices drive decisions, or how social media would give rise to disposable fashion. Online, price has more impact than the sensory qualities of clothing. “You go into a store—I love this, I love this, I love this,” he said. “You go online and you just don’t get the same sense and feel of the goods because you’re looking at a picture.”

J.Crew has about 460 stores, a smaller base than many other chains that are now shrinking their footprints. But it has still struggled as more shoppers compare prices online and buy less expensive, trendy clothes rather than a lasting wardrobe.

Amazon.com and other algorithm-based websites can change prices by the hour based on demand, and the variety of options makes it easy to mix and match brands.

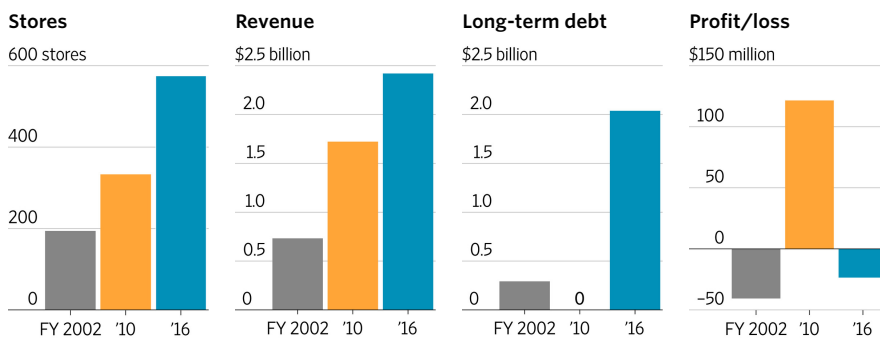
“The days of people wearing head-to-toe J.Crew are over,” said Carla Casella, an analyst at J.P. Morgan Chase & Co.

Zinniah Munoz, a 20-year-old makeup artist in New York City, said she would rather buy a style at a lower price than pay extra money for a brand name. “I’m always vigilant of not posting the same style twice” on Instagram or Facebook, she added.

At an industry conference in 2010, Mr. Drexler played down the impact of technology on prices, arguing that quality products are the key to success: “At the end of the day, I think the franchise lasts as long as the creative product gets flown through.”

Fashion Do's and Don'ts

J.Crew Group's stores and revenue have increased since Mickey Drexler became CEO in 2003, but its debt has soared since a leveraged buyout in 2011, and it recorded a loss in 2016.



Note: For fiscal years, most recent ending Jan. 28

Source: company filings

Today, with nearly two billion people using Facebook every month, he feels differently: “You cannot be successful without being obsessed with the product, obsessed with social media, and obsessed with digital,” he said. “Retail is now about all that.”

Mr. Drexler said he hasn't given up on quality. Instead, he is now lowering prices on about 300 items and creating an analytics team dedicated to optimizing prices for each garment.

“We're being much more competitive in our pricing,” he said. “We're not going to allow our competitors to take from us.”

Madewell, which caters to younger shoppers and offers cheaper prices, has outperformed the J.Crew brand, but represents only about 14% of the group's annual revenue.

Mr. Drexler is also expanding the company's supply base beyond predominantly China to get better deals and shorten the time it takes to get products into stores.

The moves are aimed at keeping prices consistent, rather than unloading leftover inventory through discounts, and at retuning J.Crew's identity as an affordable and accessible brand for everybody—not just the fashion-forward crowd.

Last month, Mr. Drexler cut 250 jobs, primarily from headquarters, and said he would part ways with Jenna Lyons, the group's longtime creative chief who was the driving force behind J.Crew's most high-price and daring styles, such as sequined blazers and feather skirts.

Mr. Drexler is also putting more of the brand's resources behind digital marketing, and shifting away from a one-size-fits-all monthly catalog. Mailings will be targeted based on customer data gleaned from the company's online business.



Mr. Drexler said he is expanding the company's supply base to get better deals and shorten the time it takes to get products into stores. PHOTO: MARLENE AWAAD/BLOOMBERG NEWS

The New York-based company is carrying more than \$2 billion of debt and has less than \$150 million in cash, following Mr. Drexler's leveraged buyout in 2011 with TPG Capital and Leonard Green & Partners. It has paid its past three interest payments by issuing new debt.

To buy time, Mr. Drexler and his fellow directors performed a complicated financial maneuver that put the company's brand and intellectual property out of the reach of debtholders. Investors are fighting the moves in court, arguing it is tantamount to a default.

At least \$560 million of debt is due in 2019. The company is negotiating with lenders to push back the due date and lower its debt load by offering to swap some of the debt for equity.

"It's unclear whether they will come to an agreement," said Raya Sokolyanska, an analyst at Moody's. "It would still leave the company highly leveraged," adding that J.Crew's capital structure is unsustainable.

Private-equity firm TPG's first big bet on J.Crew was in 1997, when it acquired a majority stake. It recruited Mr. Drexler to run the business in 2003 after cycling through four CEOs in five years. By the time TPG sold the last of its shares in 2009, the firm had made more than seven times its investment.

Mr. Drexler had nearly tripled revenue and transformed what was largely a catalog business by going in the opposite direction of his predecessors and competitors. He increased prices and elevated quality—even creating a library at headquarters to document the unique hues the brand invented each season.

When sales slipped in 2010, TPG swooped back in. In 2011, the firm partnered with Leonard Green and took the company private in a \$2.8 billion deal.

In 2014, TPG and Leonard Green were negotiating a sale of the company to Uniqlo owner Fast Retailing Co. while at the same time hiring bankers for a potential IPO, when clothing sales began to fall again. The sale plans evaporated, and by the end of the year

the company wrote down the value of its stores by more than \$500 million and its brand name by \$145 million.

TPG co-founder David Bonderman recently acknowledged J.Crew and its peers are struggling with declining mall traffic and the shift to online shopping. “The internet has proven much more resilient and much more important than most of us thought a decade ago,” he said at a conference earlier this month.

In an email, TPG co-founder James Coulter wrote, “We believe Mickey and the J.Crew management are getting the strategy and team in place to position J.Crew to succeed in this new world.”



J.Crew shirts in 2013. The company's sales at stores open at least a year have fallen for the past 10 quarters. PHOTO: CHRIS RATCLIFFE/BLOOMBERG NEWS

In recent years, customers have become closely attuned to prices. After sales began to fall, Mr. Drexler said he addressed style problems—such as “boxy” cuts that were unpopular among J.Crew customers—and quality issues, particularly pilling cashmere and T-shirts with thin fabric. Still, the company had to offer discounts of 40%-50% to move inventory.

J.Crew eventually determined shoppers were looking for better value and that many people were put off by the \$800 skirts and \$1,900 sweaters in the “J.Crew Collection”—an expensive line spearheaded by Ms. Lyons featured prominently in marketing and window displays, even though it represented a small portion of merchandise.

“We gave a perception of being a higher-priced company than we were—in our catalog, online and in our general presentation,” said Mr. Drexler. “Very big mistake.”

Ms. Lyons didn't respond to requests for comment.

Some of the quirky designs were too much for Tricia Louvar, a 42-year-old writer and illustrator in Sisters, Ore. She had shopped at J.Crew in the past, but began finding the clothes increasingly impractical and unaffordable. In a widely shared open letter to Ms. Lyons in 2015, she wrote: “I still can't wrap my head around the price of an ‘everyday outfit,’ ” which she tallied up at \$596 and said was equivalent to the price of a new computer or 298 school lunches.

In April, Mr. Drexler named Somsack Sikhounmuong, who has been with the company since 2001, to the post of chief design officer, but he won't take the high-profile role that Ms. Lyons had. J.Crew “won't be about any designer,” Mr. Drexler said. “We're getting back to being who we are—much more comfortable, approachable, democratic and friendly.”

Ms. Louvar said she returned to a store a few weeks ago for the first time in two years and bought several new pieces. “The prices felt more reasonable,” she said. “It was more like the J.Crew I remember.”

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