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**M&A deals and investments in the global fashion market:  
legal analysis and current perspectives**

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## INTRODUCTION

The global fashion business has evolved enormously since the turn of the 20th century to reach its current size and financial performance. So, nowadays the global economy regards the fashion industry as a significant sector.

The fashion market is changing on a daily basis: new brands are coming, creative fashion designers are appearing and trying to make changes in the world of fashion and become well-known to a large audience. In other words, fashion market is like a "living organism", which constantly changes and has its own needs.

Many things have been affecting the fashion industry recently. In contrast to the abrupt economic collapse, because of COVID, which the world economy experienced in 2020, the situation slowly improved in 2021 and 2022 as a result of new business tactics such as strong sustainability pledges, disruptive technology, and new digitalization methods. This situation has also affected the fashion industry.

Even though there was a serious worldwide scarcity of raw resources, businesses were nonetheless able to satisfy a considerable uptick in consumer demand and end 2022 with optimistic results. As a result, in 2022 and 2023 the fashion industry is back to its normal functioning.<sup>1</sup>

It can be even said if some investors claim that several sectors have already achieved pre-covid levels, the Fashion and Luxury (hereinafter – F&L) sector is anticipated to continue to surge with double-digit growth and approach pre-pandemic levels.<sup>2</sup>

These market dynamics are currently taken into consideration in the plans of international investors interested in the F&L sector, who are utilizing M&A activity to better and more quickly respond to these fast market shifts.

In the beginning, it is important to note that nowadays a fashion market is attractive for investors based on the following reasons.

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<sup>1</sup> Global Fashion & Luxury Private Equity and Investors Survey [Electronic resource]. Deloitte. — 2022. — URL: [https://www2.deloitte.com/content/dam/Deloitte/it/Documents/finance/Fashion-Luxury-2022\\_Deloitte.pdf](https://www2.deloitte.com/content/dam/Deloitte/it/Documents/finance/Fashion-Luxury-2022_Deloitte.pdf) 2

<sup>2</sup> Ibid.

The first one is the constant development of the fashion business, including, of course, financial performance, which has a primary interest for an investor.<sup>3</sup>

The second one is the quickening of online sales. As physical establishments were closed during the pandemic, people mostly spend their money online. This trend has continued to the present day, and consumers still continue to shop online. It has become a convenient habit. So, investors are attracted by this opportunity. For example, Asos and Boohoo, two well-known online retailers, have been given the opportunity to "dramatically gain market share by acquiring physical retail giants of the past".<sup>4</sup>

The last one is for fashion companies to demonstrate an ESG (environmental, social, and governance) agenda: "investors are under increasing pressure from clients to make sure that money is being invested in moral companies that support both the supply chain and employees".<sup>5</sup>

So, to increase their businesses, fashion corporations also utilize growth strategies including internationalization, the creation of new product categories, and ESG innovation.

Based on the data of 2022 more than half of investors (56%) want to put money into small-sized businesses, 38% of them to medium-sized businesses and 6% are interested in investing in large fashion corporations.<sup>6</sup>

So, as a result in order to be successful, thriving and be attractive for investors the brand not only needs to be responsive to demands of its customers, but also to be in line with the current tendencies on the market. The important role also plays the internal structure of a fashion company, its functioning and commercial success. These factors are also taken into account by investors.

Due to the constant development sometimes the fashion sector requires mechanisms, which allows to improve and strengthen fashion companies' positions on the market. In this case, legal mechanisms such as mergers or acquisitions can be

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<sup>3</sup> Ibid.

<sup>4</sup>Seares E. Why fashion retail is attracting investors [Electronic resource]. Drapers. — Apr.7, 2021. — URL: <https://www.drapersonline.com/insight/analysis/why-fashion-retail-is-attracting-investors>

<sup>5</sup> Ibid.

<sup>6</sup> Ibid.

regarded as an effective way to sell or purchase a stake in a company or a company as a whole.

According to a recent Global data analysis, the leaders of M&A in the fashion sphere are France and the United States of America.<sup>7</sup>

Sometimes it is needed to fully stop operations on the market or to find a solution on how to continue operating. As happens with a great amount of foreign global fashion brands in the Russian market. This question is of particular interest, because of new sanctions regulation.

New requirements for transactions (operations), involving shares in the charter capital of Russian LLCs, have been established. Now there is a requirement for such transactions to obtain permission from the Governmental Commission for Control over Foreign Investment in the Russian Federation

So, it is interesting to consider how international fashion brands act in the current situation and what mechanisms they choose.

Each of the aforementioned mechanisms has its purposes, advantages and disadvantages, and, of course, consequences for a fashion brand. So, all these factors determine *the relevance of the chosen topic* and also represent the interest in its analysis.

Mechanisms, which will be considered in this master thesis, are very modifying and depends on many factors of the deal.

*The main objective* is to analyze the mechanisms that are used in the fashion industry, to evaluate its implementation and current perspectives.

From our point of view, it is quite logical to define the main milestones of the master thesis in the form of a list of *questions that have to be answered*:

– What special features exist in M&A transactions when it comes to the fashion market?

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<sup>7</sup> Top locations for M&A deals in fashion and accessories [Electronic resource]. Just style. — May 16,2022. — URL: <https://www.just-style.com/deals-analysis/top-locations-for-ma-deals-in-fashion-accessories/>

– What is the difference between the majority and minority stakes in a fashion company? And what are the primary goals for such purchases?

– What are the most popular mechanisms in the fashion industry at the moment and how they might evolve in the future?

– What mechanisms are used when a fashion brand fully withdraws from the market?

– What mechanisms are used when a fashion brand decided to continue its operations in the particular market?

*The methodological and theoretical basis* of this master thesis is formed on the basis of general scientific methods: synthesis of information on the issue, a synthesis of normative materials and current examples of the most successful deals and investments in the fashion, as well as deduction, comparison and synthesis.

## **CHAPTER 1. Merger and Acquisition deals in the fashion industry as a main source to capitalize on opportunities**

### **SECTION 1. Preliminary stage: a strategic development and due diligence**

Through the recent decade merger and acquisition deals (hereinafter — M&A) have become a very widespread and successful mechanism in the fashion industry. This process makes it possible to extend and exploit "size" and market share of the international fashion corporations without losses in its value, to achieve synergy and prosperity after the deal will be closed.<sup>8</sup>

Generally, M&A is a complex and time-consuming process consisting of many mandatory steps. It contains more specifics when it comes to M&A in the fashion market.

In this chapter, the specifics of fashion M&A will be discussed considering the main crucial steps of the deal such as strategic development, due diligence, further processes of negotiations, and drafting documents for a successful closing, paying attention to the recent M&A deals in the global fashion market.

This section will be focused on the main aspects of the strategy: what type of deal to choose, what valuation method of the target's company is preferable, and how the due diligence process must be organised. Since M&A deals are commonly used and more widespread for foreign fashion corporations the structure and specifics of an M&A deal will be based on foreign legislation.

Any M&A deal starts with *strategic development*. In this case, there are two main options for how the company can develop its current position in the market: choosing a horizontal or vertical type of growth.

Horizontal M&A is made by acquiring competitors or companies with related product lines. A classic example of such type of a transaction is Adidas's acquisition of Reebok in 2005<sup>9</sup> or, by way of illustration, the \$49 billion merger between eyewear

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<sup>8</sup> Hays K. Mergers Could Be the New Trend in Luxury [Electronic resource]. WWD. — Apr. 3, 2017. — URL: <http://wwd.com/business-news/mergers-acquisitions/mergers-could-be-the-new-trend-in-luxury-fashion-10855930>

<sup>9</sup> The adidas-Reebok Merger [Electronic resource]. — Jan. 8, 2010. — URL: <http://www.casestudyinc.com/Case-Study-Adidas-Reebok-Merger>

giants Luxottica Group and Essilor of France in 2017<sup>10</sup> and Net-a-Porter Group's 2015 £936 million merger with yoox.com.<sup>11</sup>

Market intensification deals may offer extra synergistic advantages and can help a firm to increase its market share. This method frequently aims to inject that fleeting but essential element of up-to-date and fresh view into an old brand.

For instance, as part of its bigger plan to give Michael Kors a more global, "upmarket energy" after a protracted period of stagnant profitability, accessible luxury retailer Michael Kors Holdings purchased U.K.-based luxury footwear business Jimmy Choo for £896 million in July 2017.<sup>12</sup>

Nevertheless, living next to two former rivals might provide difficulties. The fundamental ideals on which the brands have built its identity might be undermined by managers. Therefore, it's crucial to prepare for the issues particular to each purchase and have a post-acquisition integration strategy in place.

Additionally, if the purchaser intends to expand into the related product line under its own label, buying a brand that is currently part of that line would hasten that expansion and may even allow the acquired firm to expand into the acquirer's product core competence with the acquirer's supervision.

By way of illustration, Coach Inc., a firm known for its leather goods, bought competitor handbag and clothing manufacturer Kate Spade Inc. for \$2.4 billion in May 2017 and designer footwear brand Stuart Weitzman for up to \$574 million in January 2015.<sup>13</sup>

Vertical type of growth may be chosen in a situation when companies with different activities that are not direct competitors want to do business in the same industry and strengthen its positions in it. For example, luggage and accessories or

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<sup>10</sup> Bray C., Paton E. Luxottica, Owner of Ray-Ban, in \$49 Billion Merger with Essilor [Electronic resource]. N.Y. Times. — Jan. 16, 2017. — URL: <https://www.nytimes.com/2017/01/16/business/dealbook/luxottica-essilor-merger.html>.

<sup>11</sup> Bray C., Friedman V. Yoox to Merge with Net-a-Porter in All-Share Deal [Electronic resource]. N.Y. Times. — Mar. 31, 2015. — URL: <https://www.nytimes.com/2015/04/01/business/dealbook/yoox-group-agrees-to-merge-with-net-a-porter-in-all-share-deal.html>.

<sup>12</sup> McClean P. Michael Kors to buy shoemaker Jimmy Choo for £896m. [Electronic resource]. Financial Times. — Jul. 25, 2017. — URL: <https://www.ft.com/content/c04ca84e-7106-11e7-aca6-c6bd07df1a3c>.

<sup>13</sup> Friedman V. Coach Inc. is Dead. Long Live Tapestry [Electronic resource]. N.Y. Times. — Oct. 11, 2017. — URL: <https://www.nytimes.com/2017/10/11/fashion/coach-inc-rebrands-tapestry-american-fashion-group.html>.



fragrance and cosmetics. As a result, the purchaser is able to add a product to the company's current range of goods that may be marketed in its current market or to its current clients.<sup>14</sup>

Many businesses use vertical integration, when a corporation buys a client or a supplier, as a method to gain efficiencies in purchasing, sales, and distribution. Vertical backward integration, in which a business purchases a current or future supplier, is one kind of vertical integration.

As a result of being able to buy raw materials at a more affordable price, a vertical integration may entail improved sales for the acquired supplier entity as well as increased profitability for the business.<sup>15</sup>

Large luxury fashion corporations, in particular, frequently purchase their suppliers. Chanel alone has invested in glove manufacturers, milliners, cashmere producers, and tulle and lace suppliers in addition to buying various silk businesses. Other instances include the acquisition of a tannery by Moët Hennessy Louis Vuitton (LVMH) and the acquisition of a supplier by the watch business of Hermès.

There are various benefits to vertical transactions, including better quality control, inventory control, and distribution, regardless of whether a corporation is purchasing up or down the supply line.

Strategic planning of the M&A deal is also highly important. Formulating and implementing the right strategy may lead to a successful deal. In other case avoiding this key element the deal might result to a great financial failure and further losses.

The strategy has to begin with determining the strengths and weaknesses of the fashion company - potential acquirer (purchaser). The most important issue at this point is to determine what aspects of the business can be supplied by an M&A deal.

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<sup>14</sup> Aiello R.J., Watkins M.D. The Fine Art of Friendly Acquisition. [Electronic resource] – 2000. – URL: <https://hbr.org/2000/11/the-fine-art-of-friendly-acquisition>

<sup>15</sup> Ibid.

Mostly revenues and costs of the fashion company are associated with the following sources (see Table 1):<sup>16</sup>

<b>Revenues</b>	<b>Costs</b>
– wholesale sales to retail stores and online e-commerce retailers;	– raw materials (fabric, leather, and finishings);
– direct retail sales (in brick-and-mortar stores or e-stores);	– production costs;
– ancillary royalty and/or design services revenue from licensing, franchising or collaborations.	– shipping and associated costs;
	– marketing, public relations and advertising;
	– sales;
	– retail store and e-commerce operations.

**Table 1-** Main sources of revenues and costs in the fashion industry

When considering a M&A a corporation must decide which of these resources it needs and which it can supply.<sup>17</sup>

The SWOT analysis might be helpful in this case to analyse all strengths, weaknesses, opportunities, and threats for the possible merger or acquisition.

Another aspect that must be done while planning an M&A deal is to anticipate and handle cultural and employee concerns, especially in light of growing globalization.<sup>18</sup>

The only concern is how the deal would affect the existing core business and the rest of the management structure, as well as if senior management will be overstretched as a result.

<sup>16</sup> Hand D. M&A and fashion: if the deal fits...buy it! [Electronic resource]. – 2019. – URL: <https://annualsurveyofamericanlaw.org/mergers-and-fashion/>

<sup>17</sup> Ibid.

<sup>18</sup> Campbell R. B., Jr. The Impact of Modern Finance Theory in Acquisition Cases // 53 Syracuse L. Rev. 1 – 2003. – p. 18.

In the fashion sector, where human capital plays a vital part in the success or failure of the company, predicting future challenges and preparing in advance as to how they will be managed and conquered is important. Personnel issues are not always simple to resolve. Losing an iconic designer may be disastrous for a fashion business.

A strategy for managing the company's relationship with the designer is necessary if the designer is to stay on staff. A change in the management structure might cause conflict if the designer has previously had a great deal of autonomy.

The effectiveness of the post-acquisition process may be hampered and the bottom line may suffer if the target's management and/or design team do not share the same ideals as the purchaser concerning how to expand the firm.

In each M&A transaction, the purchaser and vendor will have divergent objectives for the target's valuation. Companies must figure out how much the target firm is worth to them before deciding if a possible deal is profitable.

In achieving the right *valuation method* different methods can be used such as replacement value, comparative ratio, or discounted cash flow.<sup>19</sup>

The replacement value method comprises totaling the financial expenses of all hard and soft assets, including for example land as a hard and intellectual property as a soft. The replacement value technique has numerous shortcomings in the fashion sector, as the brand itself is a significant asset. As a result, it is rarely employed in persuasive situations.

For instance, the replacement value technique could not account for how long it might take to build a well-known brand or put together competent design and management teams who collaborate. Even if the replacement value technique takes the firm's soft assets into account, the value of the company may still not be adequately reflected.

Comparative ratios are yet another way of appraisal. A comparative ratio valuation contrasts the firm under consideration with other businesses of a similar size that is active on the market without taking part in a merger or acquisition.

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<sup>19</sup> Dolzhenko O.I. Leveraging M&A to power fashion industry // Economy and Business: Theory and Practice, vol. 7 № 89. – 2022. – p. 65-67.

Once the ratio of a comparable firm has been established, the company in question is evaluated using that multiplier. Certain financial data from the comparable company, such as its earnings or sales, create a ratio with its market price.

This approach is not usually employed in fashion transactions since there are several criteria to take into account in the fashion business and one may obtain various multiplier values based on the financial data being compared (e.g. direct to consumer sales, wholesale account sales, licensing royalty revenue, franchise sales).

Therefore, while analyzing the target's company, weighting or prioritizing is important and this judgment call makes the process less objective and accurate.

One strategy to valuing a firm that is often employed is the discounted cash flow (hereinafter - DCF) method.

In a DCF analysis, a target's company is valued at its forecasted cash flows, or the future revenue it is projected to generate, minus the appropriate discount rate.

The time value of money and risk are two significant components that make up the discount rate. The first factor recognizes that when an investor makes a financial commitment to a corporation, they "give up the use of their money for a period of time, [and]... must postpone consumption or forego a return on the invested sum [until]... the investment is returned".<sup>20</sup>

The discount rate also depicts the inherent risk in a corporation or the volatility or unpredictability of probable outcomes associated with a certain investment.<sup>21</sup>

It might be challenging to anticipate future cash flows using the DCF technique in a rapidly changing and growing sector, where new items and concepts for attracting fashion customers appear every day.

The fashion business experiences more frequent and significant changes than others. Fashion should "slip out of your hands" as Coco Chanel famously said.

The concept of preserving seasonal arts is absurd. Protecting anything that perishes the moment it is born is pointless. The value of a business might be

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<sup>20</sup> Campbell R. B., Jr. The Impact of Modern Finance Theory in Acquisition Cases. // 53 Syracuse L. Rev. 1 – 2003. – p. 27.

<sup>21</sup> Ibid.

significantly affected by these changes, especially if it is specialized in manufacturing a certain type of product.

For instance, True Religion was purchased by private equity company TowerBrook Capital Partners in 2013 for \$835 million.<sup>22</sup> Critics said that the premium denim firm failed to adapt because its "signature huge stitching and bright branding printed on t-shirts went dreadfully out of style with many younger buyers" when the company filed for bankruptcy reorganization in July 2017.<sup>23</sup>

After the strategic development is done the process of *due diligence* starts. A purchaser may only gather the informational points required to produce a well-informed prediction of the target's post-acquisition financial performance through focused due diligence.

Due diligence is a crucial component of any M&A deal since the valuation of a target depends on this analysis. Successful acquirers approach the due diligence process thoughtfully, with a plan that incorporates several players from both inside and outside the organization to evaluate the worth of the target.

The analysis of the acquired company through due diligence touches on its activities for several years before the proposed transaction, its current activities, as well as the expected future results.

However, not all businesses use the same due diligence procedure. Instead, it should be customized for the specific transaction and may differ depending on the attributes of both the acquiring and target firms, such as size, maturity, jurisdiction, and whether the target is a public or private company. Due diligence can also be modified following the requirements and preferences of the company. If the parties are anxious to close the deal, they may opt to replace more thorough due diligence with substantial representations and warranties in the sales and purchase agreement

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<sup>22</sup> Petro G. True Religion Lost Its Focus On the Consumer [Electronic resource]. Forbes. – Jul. 26, 2017. – URL: <https://www.forbes.com/sites/gregpetro/2017/07/26/true-religion-lost-its-focus-on-the-consumer/#1f15bd85cbfb>.

<sup>23</sup> Ibid.

(hereinafter - SPA).<sup>24</sup> This aspect will be covered in detail in the next section of the master thesis.

Typically, the purchaser and vendor come to an understanding of the need for due diligence during the early phases of the transaction. While some parties will start negotiating the final transaction agreements governing the M&A transaction while the due diligence review is still ongoing, other parties will prefer to wait until the review is finished, or at least well underway, before investing the time and money into drafting and negotiating lengthy agreements.

The purchaser often expects a covenant from the vendor allowing the purchaser sufficient time and access to perform due diligence to facilitate a smooth due diligence process. If a term sheet or letter of intent (hereinafter - LOI) is signed in conjunction with a transaction, this type of covenant is frequently included there as well as in the final transaction agreements. The parties will discuss including a closing condition that the purchaser's post-signing due diligence has been satisfactorily completed if the purchaser did considerable due diligence before the completion of the deal agreements.<sup>25</sup>

The target does not want the purchaser to be able to back out of a deal owing to an ostensibly minor finding during due diligence. The purchaser, on the other hand, want the security of a due diligence "catch-all" that enables it to revoke the definitive agreements if the information is discovered that is prejudicial to the value of the target.

Verifying that the target was lawfully founded, is in good standing, and has the required capacity and ability to engage into the definitive agreements are crucial initial stages in any due diligence assessment<sup>26</sup>. The target must also be clear of any existing agreements or legal obligations that bind them and the purchaser must be certain that this is the case.

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<sup>24</sup> Glukhov E.V. Sdelki kupli-prodazhi aktsiy i doley uchastnika v ustavnykh kapitalakh khozyaystvennykh obshchestv [Transactions of purchase and sale of shares and shares of a participant in the authorized capitals of business companies]. Moscow: Statut - 2019. (In Russ.) – p. 156- 158.

<sup>25</sup> Glukhov E.V. Sdelki kupli-prodazhi aktsiy i doley uchastnika v ustavnykh kapitalakh khozyaystvennykh obshchestv [Transactions of purchase and sale of shares and shares of a participant in the authorized capitals of business companies]. Moscow: Statut - 2019. (In Russ.) – p. 194- 201.

<sup>26</sup> Ibid.

To ascertain the target's capitalization, thorough due diligence must also be carried out, which includes looking through the target's stock ledger and, in the event of a stock deal, finding and obtaining all share certificates<sup>27</sup>. In the event of a stock agreement, the purchaser must be satisfied that all existing shares of stock are being transferred and that the number of shares whose favorable vote is necessary for any part of the transaction can be accurately computed.

In order to ascertain whether any of the target's assets are covered by a security interest or the target is involved in any current lawsuit, a purchaser also frequently searches public records for liens and litigation dockets. The worth of the deal may be significantly impacted by any such liens or lawsuits.

Reviewing the target's commercial and other important contracts is advised by purchasers. Which contracts (and certain clauses of such contracts) are essential to the deal's success will depend on its purpose and structure. For instance, deals involving backward vertical integration and market intensification would have distinct goals, necessitating a focus on various papers throughout the due diligence process.<sup>28</sup>

A target is typically expected to make a representation and warranty that there are no hidden liabilities that are not reflected on the target's balance sheet, in addition to representations and warranties about many other aspects of the target's business, including active litigations—and even potential future litigations, potential defaults under existing contracts, IP rights, product liability, environmental liabilities, and unpaid taxes.<sup>29</sup>

If any of these representations and warranties are broken, the purchaser will demand indemnification from the target. Despite this protection, the purchaser should nevertheless go over the due diligence papers to verify the accuracy of the vendor's claims as much as they can.

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<sup>27</sup> Reed S.F., Lajoux A., Nesvold H.P. *The Art of M&A*. // Publisher: McGraw-Hill Education. – 2019. – p. 56.

<sup>28</sup> Coates IV, John C. *Why Have M&A Contracts Grown? Evidence from Twenty Years of Deals*. // Harvard Law School John M. Olin Center Discussion Paper – 2016. – p. 57.

<sup>29</sup> *Ibid.*

Instead of filing an indemnification claim against the vendor after the deal closes, the purchaser should be aware of a latent liability and account for it in a lower purchase price, if not in the choice to proceed with the acquisition at all.<sup>30</sup>

A due diligence requests list, which often includes the following list of topics and documents to evaluate. From our point of view in a fashion M&A deal the due diligence process must contain the following aspects:

- all financial statements that indicate the company's historical operations and financial performance;
- key intellectual property (such as design patents, trademarks, trade names, and copyrights);
- leases, title documents to the estate, personal property, and business property;
- licence and collaborative agreements;
- market studies/reports on the company's product; and
- relative profitability of the company's various classes of products and business segments compared to companies of similar size in the industry (i.e., contact major customers to determine their level of satisfaction).<sup>31</sup>

A special feature of fashion M&A deal is the need to conduct the IP and designer due diligence.<sup>32</sup>

A thorough and accurate IP examination is especially important when it comes to transactions involving the fashion sector. The vendor's most valuable asset is typically their IP. In order to verify ownership and to make sure there isn't any potential litigation that may arise over the use of the brand name or the designs, due diligence review in a fashion transaction should look into all trademark, copyright, and design patent registrations, both domestically and internationally. Both where such IP is now utilised and in future expanding areas, this should take place. It goes without saying that the costs involved with conducting legal reviews across several countries can increase as it normally takes several law firms to conduct a thorough study.

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<sup>30</sup> Feldman R. Black Holes and Boilerplate in M&A Practice. // Business Law International. – 2018. – p. 140-159.

<sup>31</sup> Ibid.

<sup>32</sup> Jimenez G.C., Kolsun B. Fashion Law: A Guide for Designers, Fashion Executives, and Attorneys. // Fairchild Books. – 2nd edition. – 2014. – p. 216.



In cases where registration is not allowed or was simply not done by the target's company, the IP assessment must also take into account common law IP rights. The date of first use, proof of that use, and proof of secondary meaning should all be obtained in the case of unregistered trademarks, which are typically restricted to names used for specific products rather than the brand name itself, trade dress, or other IP that is not registered and should be verified for accuracy.<sup>33</sup>

Sometimes M&A deals are made especially for receiving an IP of one fashion brand by another. An example of this type is the recent deal of Next, a British apparel retailer, which has agreed to acquire Cath Kidston, a fellow fashion company that was recently thrown into administration. Cath Kidston's trademarks, domain names, and other intellectual property will be purchased by Next for £8.5 million (\$10.5 million).<sup>34</sup>

Considering the designer's due diligence, the requirement to ascertain what function the namesake or lead designer and design team will play in the future of the business once the deal is completed is a crucial factor for a purchaser of a fashion firm, and it distinguishes the fashion M&A due diligence process.

In addition to creating the products, a head designer — especially in a smaller fashion house, but frequently in larger ones as well — may also have the power to decide on licencing, the types of markets the products are sold in (such as couture, ready-to-wear (RTW), and contemporary), the types of raw materials that are sourced, and the locations where the products are sold.<sup>35</sup> Moreover, some designers may want to sell only to the highest-end retailers, which may result in significant negotiation between the parties.

Thus, the future of the brand is significantly influenced by whether an eponymous or lead designer remains or departs once the transaction is completed, both from a design and an image standpoint. As a result, where applicable, as part of the due diligence process, the purchaser will almost always meet with the namesake or lead designer and the design team numerous times to talk about the future of the to-be-

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<sup>33</sup> Ibid.

<sup>34</sup> A running timeline of fashion Mergers, Acquisitions & Investments [Electronic resource]. The fashion law. – Mar.28, 2023. – URL: <https://www.thefashionlaw.com/a-running-timeline-of-fashion-and-luxury-mergers-acquisitions/>

<sup>35</sup> Ibid.

acquired firm. Losing an eponymous or lead designer might make the brand less valuable and, as a result, prompt an interested party to offer less money for it than it would have if the designer had stayed.

For instance, had Ms. Karan not left the brand the year before, LVMH could have been able to get a better price for DKNY in its 2016 sale to G-III Apparel Group.<sup>36</sup> The degree of influence an eponymous or lead designer has over the regular operations of the business, both in terms of design and in terms of management and operations, may also have an impact on how much significance is placed on them.

While some designers may be the driving force behind the design, they frequently delegate to a highly skilled design team that is familiar with the brand's style and might, therefore, duplicate it in the future. Some designers could also assign management and operational duties to a qualified group, which might facilitate the sale of the company to the purchaser. As a result, losing an all-encompassing lead or namesake designer would probably have a far worse effect on the business and the brand than losing a designer who has properly delegated and has a broader creative influence.

Both sides considered Stuart Weitzman's impending retirement when his namesake line was purchased by Coach Inc. in 2015. Because of this, there was no negative impact on the brand as a result of the transition when Mr. Weitzman left his position as lead designer the following year. He continued to be actively involved in the choice of the newly designated creative designer and design team.<sup>37</sup>

Another crucial step for potential purchasers is to have a conversation with the main or eponymous designer about the company's future course. This may be important in cases when the designer is anticipated to leave the organisation, even though it is far more crucial in the event that they stay.

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<sup>36</sup> Vidalon D., Wendlandt A. LVMH sells loss-making Donna Karan to G-III in \$650 million deal [Electronic resource]. Reuters. – Jul. 25, 2016. – URL: <https://www.reuters.com/article/us-lvmh-donna-karan-idUSKCN1050FE>

<sup>37</sup>Weilheimer N. Exclusive: Stuart Weitzman Talks to FN About Calling It Quits After 50 Years [Electronic resource]. Footwear News. – Mar. 20, 2017. – URL: <http://footwearnews.com/2017/business/designers/stuart-weitzman-celebrity-red-carpet-shoes-retirement-328770/>

Regardless of whether they stay in business or leave, an eponymous designer could, for instance, try to restrict the use of their name to specific product categories or set the routes of distribution. Such possible restrictions should be considered with the designer as part of the due diligence process because licensing/franchising and brand expansion have developed into such powerful profit-raising methods for fashion corporations. An eponymous designer must be prepared to licence their name to several product categories, for instance, if part of the acquirer's development goal is to transform a business that solely sells RTW into a lifestyle brand.

As an alternative, the purchaser needs to make sure the designer is on board if they wish to take a couture brand and develop an RTW and modern range. Eponymous designers could view their brand as an extension of themselves and, as a result, might be less inclined to implement these potentially very lucrative techniques because they fear perceived harm to their reputation.<sup>38</sup>

The management structure of the business and the person in charge of strategy are two crucial factors to take into account throughout the due diligence process. To stay with the firm, an eponymous or lead designer may require a certain level of influence over the business.

A purchaser with a clear strategic vision for the brand who would be vulnerable to the designer's influence might not be able to accommodate such a requirement. Additionally, even if the designer gives up some of his or her authority over the business, an effort must be made to make sure that the designer will fit in well with the new management system.<sup>39</sup>

When all these necessary "preliminary" aspects are done and suit the potential purchaser, it can be said that parties of the deal can pool production, intellectual and financial capacity and significantly reduce production costs and thereby increase profits, because primarily the main purpose of M&A is the opportunity to improve financial performance and reduce costs and risks.

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<sup>38</sup> Jimenez G.C., Kolsun B. *Fashion Law: A Guide for Designers, Fashion Executives, and Attorneys.* // Fairchild Books; 2nd edition. – 2014. – p. 222.

<sup>39</sup> Jimenez G.C., Kolsun B. *Fashion Law: A Guide for Designers, Fashion Executives, and Attorneys.* // Fairchild Books; 2nd edition. – 2014. – p. 222-224.

## **SECTION 2. Main stage: transaction structure through negotiations and documentation process in order to go into a successful closing**

When the M&A strategy and due diligence are properly done, it is a time to start a negotiation process on the main part by drafting the sales and purchase agreement (hereinafter - SPA) in order to achieve integration and go into a successful closing of the deal. From both sides: the potential purchaser and vendor it must be decided whether to move forward or not.

If the purchaser has not found any big problems during the previous steps it may mean that it is a time to start negotiations in order to conclude the SPA.

In an M&A transaction, drafting an SPA can be time-consuming. Each SPA party works to create a contract that is most advantageous to them and has the least amount of risk exposure.

Even when the parties ultimately reach an agreement on a contract that is in line with their interests, disagreements over a variety of topics, such as the precise nature and extent of warranties, may still occur after the transaction has been completed. By way of illustration, in 2020 in preparation for the SPA related to the biggest M&A deal in the luxury fashion world might not have been, but it ended well, with conglomerate LVMH acquiring US jewellery company Tiffany & Co. for \$15.8 billion.<sup>40</sup>

Each SPA, normally contains obligatory parts, which both parties are needed in order to go into a successful closing.

Firstly, each SPA lists the number of shares to be bought as well as the rights, title, and interest that the purchaser will acquire in the shares. Additionally, this section needs to include the purchase price for the shares, the method of payment (cash, securities of the purchaser, assumption of debt/liabilities, exchange of assets (real estate, personal property, intellectual property, etc.), or a combination of the above), as well as the date and location of the transaction closing.<sup>41</sup>

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<sup>40</sup> A running timeline of fashion Mergers, Acquisitions & Investments [Electronic resource]. The fashion law. – Dec.23, 2022. – URL: <https://www.thefashionlaw.com/a-running-timeline-of-fashion-and-luxury-mergers-acquisitions/>

<sup>41</sup> Clifford J.F, Jonkhart F., Pearlman J. What's the Market for That Cross-Border Deal – The European, US and Canadian Private Target M&A Deal Points Studies. // Business Law International. – 2011. – p. 154.

In this regard, it should be made clear if the SPA's execution and closing will occur simultaneously or whether there will be a delay (a deferred closing).

Deferred closings are widespread and may be essential for a number of reasons, especially in fashion M&A. The complete purchase price may not always be paid at closing. Instead, a part may be due upon the occurrence of specific future events, whether contemporaneous or postponed.

By way of illustration, Tom Ford will be acquired by Estée Lauder Companies for \$2.8 billion using a mix of cash, debt, and deferred payments totaling \$300 million, which will be the "biggest and latest in a series of transactions" and the biggest deal in the luxury space in 2022.<sup>42</sup>

The acquisition price is often established in proportion to a target's most recent financial statements in the majority of M&A deals. A purchaser is often protected by purchase price adjustments against changes in the target's worth between the date the target was appraised and the transaction's close. In this regard, the purchaser and vendor must concur on a value methodology and have accounting standards that are equivalent or reconcilable.<sup>43</sup>

Earn-outs usually consist of contingent, supplementary payments that might be provided after the closure upon reaching specific performance criteria in the future and expire on a set date. It becomes highly important when we are talking about fashion M&A, where the performance of the target company plays a crucial role.

Earn-outs provide the vendor with a higher price if it meets the earn-out goals while reducing the acquisition risk for the purchaser. Earn-outs can help manage disagreements about the value of the target if, among other things:

- uncertainty exists about its prospects;
- it is a small fashion company or new brand with limited financial results but has growth potential;
- or where the vendor will continue to manage the company and the purchaser wants to motivate the vendor's future performance.

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<sup>42</sup> Ibid.

<sup>43</sup> Reed S.F., Lajoux A., Nesvold H.P. *The Art of M&A*. // Publisher: McGraw-Hill Education. – 2019. – p. 83.

Earn-outs can be financial (for example, hitting future sales targets) or non-financial (for example, key customers of the target are maintained after the transaction).

Earn-out provisions must be carefully drafted and should include very specific milestones, a clear earn-out period, a clear formula or method for determining the earn-out, a method of securing the earn-out payment (such as escrow or a guarantee), and earn-out-specific post-closing covenants.<sup>44</sup> This is because there are risks related to the misrepresentation of achievements or simply unaligned accounting policies. An earn-out can be thought of as an extra payment for reaching pre-established post-closing objectives.

A SPA may also include a section on material adverse effect (hereinafter - MAE). It is used to establish a cutoff point for gauging a given event's detrimental impact on the target firm. A purchaser will want to be protected against purchasing a company that has undergone significant change since it signed the SPA (typically where there is a deferred closing). It is customary to qualify statements, guarantees, and covenants using MAEs.<sup>45</sup>

As a result, a condition precedent can be included in an SPA that allows a party to decline to conclude a transaction if the counterparty has experienced MAE between the time the SPA was executed and the closing (a bring-down).<sup>46</sup>

The representations and warranties provided at the time the SPA was signed are reaffirmed at closing due to a bring-down clause. The representations and warranties provided at the time the SPA was signed are reaffirmed at closing due to a bring-down clause. The parties negotiate MAE, which must be expressly stated in the SPA's definitions. The kind of transaction, industry, and negotiation strength of the parties all influence how broadly the MAE is used.

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<sup>44</sup> Feldman R. Recent Trends in European SPAs and Comparisons with US Practice. // *Business Law International*. – 2016. – p. 217-231.

<sup>45</sup> Lalafaryan N. Material Adverse Change Uncertainty: Costing a Fortune If Not Corporate Lives. // *Journal of Corporate Law Studies*. – 2021. – p. 39-41.

<sup>46</sup> Pate K. *Agile M&A: Proven Techniques to Close Deals Faster and Maximize Value*. – 2018.

The next point to consider in SPA related to the fashion industry is conditions precedent, often known as closing conditions. These are requirements that must be met or waived by all parties before the purchase may complete. Although conditions prior are frequently assigned to a particular party, some of them may apply to both parties.<sup>47</sup>

The counterparty normally has the right to withdraw from the transaction without penalty if a closure condition is not met. By doing this, the parties are shielded from not getting what they agreed to.

In the case of a postponed closure, something may happen after the SPA is signed that would force a party to end the SPA before closing (by mutual agreement or due to the occurrence or lack of occurrence of specified events).

The obligatory part of SPA, which is also related to the fashion M&A is representations and warranties.

Both parties make representations and warranties about their willingness to reveal important information to one another during M&A transactions.

Although a vendor's representations and warranties are typically more thorough because they cover information about the target company, its operations, assets, and liabilities, they can still work in the vendor's favour depending on the parties' relative negotiating strength and the specifics of the deal.

In the event of a misrepresentation or breach, representations and warranties serve as risk allocation tools between the parties and serve as the foundation for legal action. They are essential to an M&A transaction and can be as intricate or straightforward as the parties agree upon.

To give greater grounds for termination and indemnity, purchasers generally demand from vendor's wide, unconditional, and unqualified representations and guarantees. By limiting representations and warranties to "material" issues alone and using "knowledge" criteria to limit assertions of fact to topics about which the vendor

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<sup>47</sup> Ibid.

has or should have, actual information, vendors can reduce the risk associated with such disclosures.<sup>48</sup>

Qualifying representations and warranties can lower the likelihood of upcoming allegations of misrepresentation and warranty violation based on the omission of crucial facts. By limiting claims and guarantees to specified time frames, vendors can also cut back on risk.

In a SPA, purchasers also give warranties and representations. A vendor often wants to make sure the purchaser can close the deal and has the money to pay the purchase price.

An SPA would often include an indemnity language that covers culpability for damages suffered as a result of misrepresentations and breaches of warranties, covenants, and other agreements. This is a highly negotiated and nuanced topic.

To make such claims, the indemnity provision may be written as either an exclusive or a non-exclusive remedy.<sup>49</sup> The indemnification clauses must be the only and exclusive remedy and shall set forth any limits or conditions with respect to payment and liability, including the time and manner of filing, processing, and payment of claims. The parties would often be deemed to have waived all other remedies under the applicable law by agreeing to an exclusive remedy. This exclusivity is, however, subject to exceptions for fraud, willful misconduct, deliberate breaches, and equitable remedies.

Another point is pre-closing covenants. They typically place restrictions on the vendor's actions prior to the transaction. Because the vendor often retains control of the target until the deal closes, covenants provided by the vendor are typically more stringent than those provided by the purchaser.<sup>50</sup>

Pre-close covenants, which serve as commitments to do or refrain from doing specific things, are frequently used in deals with deferred closings to safeguard and

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<sup>48</sup> Cavallo P. Notes on the ABA 2019 European Private Target M&A Deal Points Study [Electronic resource]. – 2021. – URL: [https:// portolano.it/en/newsletter/portolano-cavallo-inform-corporate/notes-on-the-aba-2019-european-private-target-ma-deal-points-study](https://portolano.it/en/newsletter/portolano-cavallo-inform-corporate/notes-on-the-aba-2019-european-private-target-ma-deal-points-study)

<sup>49</sup> Ibid.

<sup>50</sup> Feldman R. Recent Trends in European SPAs and Comparisons with US Practice. // *Business Law International*. – 2016. – p. 235.



maintain the value of the business being bought between the execution of the SPA and the closing of the acquisition. As stated above the deferred payment and as a result closing can be regarded suitable for the fashion M&A deals.

Pre-closing covenants require the parties to the SPA to make efforts and they must negotiate the legal standard of effort. Best efforts are the greatest standard of duty, while commercially reasonable efforts are the lesser standard of obligation to complete the deal. In addition, termination rights, which would allow a party to end the SPA before closure, are associated with closing conditions.<sup>51</sup>

Post-closing covenants, which take effect after a transaction closes, may also be included in SPAs. Post-closing covenants are contextual and specific to the interests of the parties. Among other things, they might:

- make sure the purchaser works with the vendor to save certain business and tax documents;
- prevent the vendor from competing with the target firm;
- prevent the vendor from soliciting personnel of the target company;
- make that the counterparty is not using any IP that has been transferred to the buyer or held by the seller in connection with the transaction.

Another important point to consider in a fashion M&A deal is non-disclosure agreement (hereinafter - NDA). A standard clause in an SPA states that the agreement's provisions, including its existence, are considered secret information and should not be shared with any other parties.

However, any prior NDA that was (and should have been) signed by the purchaser and vendor during a previous phase of the transaction, for example as the due diligence phase, should be specifically referred to in this language and incorporated. It should also be emphasised that any such agreement is still in full force and effect until it expires or is replaced.<sup>52</sup>

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<sup>51</sup> Sherman A.J. Mergers and Acquisitions from A to Z. // 3rd ed., AMACOM Division of American Management Association International. – 2011. – p. 15.

<sup>52</sup> Glukhov E.V. Sdelki kupli-prodazhi aktsiy i doley uchastnika v ustavnykh kapitalakh khozyaystvennykh obshchestv [Transactions of purchase and sale of shares and shares of a participant in the authorized capitals of business companies]. Moscow: Statut - 2019. (In Russ.) – p. 386

Any NDA language in the SPA may reflect amendments to earlier NDAs, integrate earlier NDA language by reference, supersede earlier NDAs entirely, or maintain that only language in the earlier NDA that is in conflict with the SPA is superseded. It is important in the fast-changing world of fashion.

Additionally, this SPA clause in fashion M&A should have wording that is limiting in terms of press communications. Unless the parties to the SPA agree otherwise, any press releases, public announcements, conferences, or ads pertaining to the transaction, the SPA, or its existence shall be banned.

In order to preserve proprietary information, vendors frequently request that definitions of private information be written as wide as feasible. In contrast, purchasers often choose less comprehensive definitions to reduce potential responsibility.

As part of an NDA, non-compete and non-solicitation clauses are frequently included. For a predetermined amount of time following the closure, they are covenants that prohibit a vendor from going up against the target firm and from contacting its clients, workers, or customers.<sup>53</sup>

Finally, a SPA outlines the legal conditions that will govern the transaction. Nevertheless, depending on which national laws are in force, such phrases will have different meanings and consequences. A choice-of-law provision is an agreement between two parties that specifies that the SPA should be governed by and construed in accordance with the laws of a certain country.

It would be unusual for a SPA to eliminate a choice-of-law clause. The absence of a choice-of-law clause in a SPA would subject the parties to extra expenditure and complicated regulations to choose which law to apply by taking into account, among other things, where the parties are located and where their responsibilities are to be fulfilled.

When it comes to international M&A, failing to define the legislation that would apply to any disputes might be disastrous, especially when the purchaser and vendor

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<sup>53</sup> Ibid.

are domiciled in different countries and have subsidiaries and assets located in several other countries.

A good SPA cannot salvage a poor business purchase. However, an SPA is a crucial instrument to reduce risk in M&A when it is supported by a well negotiated and a strong due diligence.

To create a complex and well-structured SPA as well as ancillary papers that adequately suit the goals and objectives of the parties to an M&A transaction, as well as to manage and coordinate all the moving pieces is a key for successful closing and further synergy of the "players" on the fashion market.<sup>54</sup>

As has been demonstrated process of an M&A deal is lengthy and requires a lot of aspects to consider. However, it is one of the most suitable mechanisms of business development in the world of big fashion corporations.

In most cases, M&A results will lead to synergy, further prosperity, and capitalization of opportunities. As a result, the number of M&A in fashion is growing year by year.

In this chapter two main stages of M&A in fashion were demonstrated: the preliminary related to the strategic development and due diligence, and the main one which is devoted to the negotiations, ancillary papers, and of course drafting of SPA.

When an M&A deal is used in the fashion industry it is not enough to consider just the ordinary content and process of the M&A. The role of the lead designer, future strategy for integration, fashion designs as intellectual property, and even the history of the target company must be taken into account through the whole process of M&A because it plays a highly important role in such types of deals.

So, the main focus should be on the planning of the transaction, the parties to the transaction need to understand exactly what goals they want to achieve.

Moreover, it is also necessary to pay special attention to the process of due diligence. This process is primarily important in assessment of the actual state of the target fashion company, examine its financial performance and overall performance.

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<sup>54</sup> A running timeline of fashion Mergers, Acquisitions & Investments [Electronic resource]. The fashion law. – Dec.23, 2022. – URL: <https://www.thefashionlaw.com/a-running-timeline-of-fashion-and-luxury-mergers-acquisitions/>

If these aspects are not analysed enough, a deal may not lead to a successful closing and further results.

The analysis of the recent deals in the fashion market only reinforces the conclusion that M&A is the most effective and frequently used mechanism for brand development.

## CHAPTER 2. Main mechanisms of investments in the fashion industry

### SECTION 1. Purchase of a majority stake as a way to gain influence in a fashion company

In the first chapter we have analysed the process of M&A deals, which has a lot of specifics and serious consequences for a fashion brand after closing the deal.

So, M&A is a complex and lengthy process, which involves transferring various company's assets and also company's shares that are the deal's target.

In this chapter, we would like to focus on the mechanism of purchasing the shares of the company to enter into a business internal management within the process of M&A. In this case, for an investor, it is crucial to decide whether to purchase a majority stake or to join a brand by purchasing a minority block of stakes.

In this section, we would like to analyse the mechanism of purchasing a majority stake, which allows an investor to receive a wide range of possibilities and gain an influence within a fashion brand. *What advantages and disadvantages is this mechanism beneath in itself? How does it work in the fashion market?*

After that in the second section of the chapter it is interesting to consider other option – a purchase of a minority stake in order to show the main distinctions between them, which has a completely different purpose and intention of an investor to enter into a fashion brand.

So, from our point of view it is better to start with *the definition of a majority shareholder*.

In practice, the majority shareholder is understood to be the owner of such a block of shares that allows him/her to participate in the management of a legal entity and influence the decisions made.

The majority shareholder can participate in the management of a company only by voting - making significant decisions regarding the composition of the company's management bodies, policy, vector of development, transactions to be concluded, distribution of profits and other decisions.<sup>55</sup>

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<sup>55</sup> Levushkin A.N. Assurance of a Balance of Interests of Majority and Minority Shareholders in Corporate Relations. // Civil law. №6 - 2022. // SPS Consultant Plus (in Russ).

The exact size of the shareholding that allows the exercise of management rights is determined by the legal entity itself in its statutory documents.

In other words, it is the size of the stake at which the shareholder has the right to significantly influence all processes within the company. All in all, practically it can be said that mostly this is a person or organization that has and controls more than 50% of the outstanding shares of a corporation.

The presence of a majority shareholder in a fashion company plays a very important role, as in most cases he or she is the one, who plans the company's current and future activities and is standing at the helm of important decisions in general.

Fashion has some specifics, when it comes to purchasing of a majority stake. Here we have to understand that it has special goals, for example, fashion brand holds a stable position in the market, but wants to develop and expand its market share globally, here we may follow up with the tendency, when the big *investment companies* purchase a majority stake in the brand.

Here are some tiny specifics of such M&A deal and such purchase, because there is no interest in transferring assets of the companies.

The main purpose of such purchase for an investor is to enter into the brand in order to implement its knowledge and improve financial indicators of the company, so this type of investors want to gain influence in a fashion company through the control of internal processes of a brand.

By way of illustration, such a mechanism is often used by the company "L Catterton" - a leading global consumer-focused investment firm. This company was formed in 2016 through the merger of the Arnaud family holding company with US investment Catterton.<sup>56</sup>

Thus, on 2 March 2023, it was announced that "L Catterton Europe" is planning to buy a majority stake in A.P.C. (Atelier de Production et de Création).<sup>57</sup>

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<sup>56</sup> See information about the company. – URL: <https://www.lcatterton.com>

<sup>57</sup> A running timeline of fashion Mergers, Acquisitions & Investments [Electronic resource]. The fashion law. – Mar.10,2023. – URL: <https://www.thefashionlaw.com/a-running-timeline-of-fashion-and-luxury-mergers-acquisitions/>

A.P.C., the independent French company, was established in 1987 in Paris by Jean Touitou. Now he has decided to sell the bulk of its stock to the investment group "L Catterton Europe", creating a strategic alliance to expand the brand abroad. The company's founders will continue to hold a significant minority. By the end of the quarter, the deal is anticipated to be completed.

The transaction's financial details were not disclosed, but "L Catterton Europe" partner Eduardo Velasco believes that A.P.C. has the potential to soon surpass €300 million in annual revenue owing to its omnichannel approach.<sup>58</sup>

The French company, which specializes in unpretentiously stylish and basic — but not ordinary — clothing and accessories, including its best-selling Japanese selvedge denim, will continue to be run by Jean and his wife Judith Touitou, who also serves as creative director.

As a result of the agreement, current CEO François-Cyrille de Rendinger will now serve as president, while current deputy CEO Jol Sraer will take over as CEO.

With the investment, A.P.C. hopes to strengthen its position in the US and expand further in Europe and Asia, particularly China. This will involve increasing its footprint in retail and wholesale markets as well as online, where approximately 30% of sales are made.<sup>59</sup>

It must be said that "L Catterton" is a well-known market "player", this investment company is backed by LVMH (Louis Vuitton Moët Hennessy). It has previously made successful investments in Etro, Birkenstock, Savage x Fenty, Gentle Monster and Ganni<sup>60</sup> (see Table 2).

<b>Company</b>	<b>Year</b>	<b>Amount of shares</b>	<b>Approximate purchase price</b>
Ganni	2017	No information	between \$500 million and \$700 million
Etro	2021	60%	€500 million

<sup>58</sup> Ibid.

<sup>59</sup>Phelps N. A.P.C. to sell majority stake to L Catterton [Electronic resource]. Vogue business. – Mar. 1, 2023. – URL: <https://www.voguebusiness.com/companies/apc-to-sell-majority-stake-to-l-catterton>

<sup>60</sup> Ibid.

Savage x Fenty	2021	No information	\$115 million
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**Table 2** – Main deals of purchasing a majority stake in the fashion company, made by "L Catterton"

Thus, in 2021 "L Catterton" purchased a majority stake in German footwear manufacturer Birkenstock, valuing the company at €4bn. Financiere Agache, owned by LVMH chief Bernard Arnault's company Groupe Arnault, was also involved in the deal.

Brothers Christian and Alex Birkenstock will retain a stake in the company. The companies did not disclose the terms of the agreement.<sup>61</sup>

The primary goal of this investment was to achieve global growth in the Chinese and Indian markets, as well as to increase online sales and direct-to-consumer sales.

So, we can conclude that the main goal of the investment company, when it purchases shares in a fashion company, is to preserve the brand values while improving the value proposition: branding, product, channels, supply and structure.

The tendency of purchasing a majority stake in a fashion company is gaining momentum every year.

Thus, on 11 April 2023 it became publicly known about the new investment company, which has its primary focus on fashion brands - ChimHaeres Investment Holding.

In its first transaction in the fashion industry, ChimHaeres Investment Holding, a recently established joint venture between private investment firm Chimera Abu Dhabi and private equity investment company Haeres Capital, has acquired a majority stake in Vionnet. The company is seeking to create a new luxury and lifestyle European player looking to revive French haute couture.<sup>62</sup>

The terms of the transaction were not made public.

Furthermore, ChimHaeres will incorporate its majority ownership of the Italian hat maker Borsalino into the new business.

<sup>61</sup>Birkenstock sells majority stake to L Catterton [Electronic resource]. Reuters. – Feb.26,2021. – URL: <https://www.reuters.com/article/birkenstock-ma-catterton-idUSS8N2KN0CO>

<sup>62</sup> A running timeline of fashion Mergers, Acquisitions & Investments [Electronic resource]. The fashion law. – Apr.11, 2023. – URL: <https://www.thefashionlaw.com/a-running-timeline-of-fashion-and-luxury-mergers-acquisitions/>



To cater to a younger and more international client base, ChimHaeres will focus on "heritage" and "next-gen" companies with "favourable growth prospects". The company's first emphasis is on businesses in the United Kingdom, Italy, France, and Switzerland.<sup>63</sup>

ChimHaeres is searching for opportunities to invest in great aspirational brands in order to build on its early investments.

Another situation is when *big retailers* purchase stakes in a fashion company.

For example, on 16 December, 2022 Frasers Group purchased majority stake in JD Sports' premium apparel brands as the British retail chain seeks to expand into more upscale markets. According to Reuters, "Frasers", formerly known as Sports Direct, also bought and transferred shares of more than 10 of the premium fashion companies, including Pretty Green, Cricket, and Topgrade Sportswear, which were owned by the sports retailer.<sup>64</sup>

Sometimes the fashion brand intends to develop its name itself then there is a possibility to sell a majority stake to a specialized *brand management company*.

By way of illustration, WHP Global – a brand management firm takes a controlling 70% stake in Isaac Mizrahi fashion brand.<sup>65</sup>

Moreover, fashion is so closely connected with the consumer's demands. Nowadays we are facing a situation where luxury brands have also been quick to recognise the potential of social media platforms and social influencers to promote their products directly to their target audience with great success.

So, sometimes it is needed for the brand to develop online, in this case. purchase of a majority stake by *online platforms* is also so popular and wide spreading.

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<sup>63</sup> Ibid.

<sup>64</sup> Mike Ashley's Frasers buys JD Sports' premium fashion brands for \$58 mln. [Electronic resource]. Reuters. – Dec. 16, 2022. – URL: <https://www.reuters.com/markets/deals/mike-ashleys-frasers-buys-premium-fashion-brands-retailer-jd-sports-2022-12-16/>

<sup>65</sup> Forest F. WHP Global takes majority stake in Isaac Mizrahi fashion brand [Electronic resource]. Just style. – Jun.6, 2022. – URL: <https://www.just-style.com/news/whp-global-takes-majority-stake-in-isaac-mizrahi-fashion-brand>

For example, in 2022 Zalando, a leading online platform for fashion and lifestyle in Europe acquired a majority stake in Highsnobiety.<sup>66</sup>

Together, the two businesses will set the bar for client engagement and inspiration. By combining Zalando's fashion network, e-commerce know-how, and operational capabilities with Highsnobiety's cultural relevance and insight, fashion authority, and storytelling expertise, they will take use of each other's complimentary assets.

Highsnobiety will continue operating independently while serving as a strategic and creative advisor to Zalando as it develops new inspiration-focused areas and formats on its platform. Zalando's goals to include inspirational experiences into the customer journey and provide a dynamic and engaging online environment for both consumers and businesses will benefit from Highsnobiety's special talents. Highsnobiety is now able to use Zalando's resources and experience to support its own e-commerce capabilities as a result of joining the Zalando Group.

All in all, the process of purchasing a majority share is fully connected with M&A, the process of which we have discussed in the first chapter of this master thesis.

Owning a majority stake in the company means that you can control its internal functioning and operation.<sup>67</sup> The main advantages of having a major shareholder in a company are the following:

Firstly, resources are concentrated and allocated to the highest priority areas declared by the majority shareholder;

Secondly, the majority shareholder has greater involvement in the management of company affairs and intention for the global growth of the fashion company;

Thirdly, the majority shareholder has a vested interest in increasing control over the actions of management, safeguarding the company's assets.<sup>68</sup>

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<sup>66</sup> Zalando acquires majority stake in Highsnobiety [Electronic resource]. Zalando. – Jun.13,2022. – URL: <https://corporate.zalando.com/en/company/zalando-acquires-majority-stake-highsnobiety-bringing-together-content-and-commerce>

<sup>67</sup> Korolev V. A., Semenov A. S. Corporate governance in the companies with the owner of the controlling. // Actual material. – 2019. – p. 4-14.

<sup>68</sup> Ibid.

However, the presence of a majority shareholder not only creates advantages, but also risks for other shareholders. Among them it can be named, for example, the risk of making poorly thought-out decisions: often the majority shareholder causes the implementation of unjustified, unfinished decisions which, in his opinion, should benefit the entire company. With his controlling interest, he can insist on his decision. In this case we might observe the situation when global development and financial performance of the brand stands above DNA of the brand and its historical background.

When we are talking about global fashion brands this risk can be minimised. As mentioned above in the case of an acquisition of a majority stake by an investment company or a fashion retailer the designer or the founder of the brand remains the crucial person in business operation, who helps the brand not to lose its fashion DNA, save its historical values and specifics - in other words the designer or the founder remains to serve as chief design officer.

From our point of view in such cases a new majority shareholder acts mainly as a financial support for the brand and also as a development director.

To sum up, in the fashion market there are several tendencies when the mechanism of purchasing a majority stake benefits both a vendor and a purchaser, they are the following:

- Purchasing a majority stake by an investment company is useful for attracting additional capital and investment to achieve global growth in foreign markets;
- Purchasing a majority stake by a retailer is helpful to expand sales channels;
- Purchasing a majority stake by a fashion online platform is beneficial for brands, which want to provide a dynamic and engaging online environment;
- Purchasing a majority stake by a brand management firm helps a fashion company to develop its brand with the help of a marketing specialist.

Despite these options, the crucial thing here is that a new majority shareholder identifies only areas for improvement in the brand, based on its specialization and expertise, but the brand's creator or designer is still a key player in company operations, helping it to retain its unique fashion DNA and preserve its historical values and peculiarities.

## **SECTION 2. Purchase of a minority stake as a new way to invest in new designers and emerging brands**

In the first section, it has been discussed a purchase of a majority share in a fashion company, its advantages seem quite logical for both parties: the purchaser receives a wide range of legal rights and possibilities within a company related to the functioning of the business and its global development.

Now we have to discuss the situation, when an investor wants to enter into a business through purchasing a minority stake. *Why this option is attractive for investors? What are the main goals of the investor for making such investment? Moreover, why it seems attractive for investors to enter into a new brand?*

New fashion brands are appearing daily. In the beginning some of them have a lack of financial possibilities, it takes some time for the brand to grow, to become recognisable to customers. In this case the bigger ones come to the rescue, providing new fashion brands with opportunities and boosting them to the success.

The biggest player on the fashion market – LVMH supports such investments. This global and widely known company has a special division – Luxury Ventures, which is specialised in purchasing a minority stakes both in B-to-B (business to business) enterprises that assist the digital transformation of the luxury sector and of the consumer goods industry in general, as well as in up-and-coming B-to-C (business to customer) luxury brands with significant development potential.<sup>69</sup>

From our point of view, it is quite interesting to consider the philosophy of this company and its criterion for making an investment.

So, its philosophy is based on three key points:

– *Authenticity and Innovation*. Company's target brands combine authenticity, creativity, and attractiveness to create a distinctive character. They mostly collaborate with entrepreneurs that have a clear vision and are gifted and driven by a keen business sense;

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<sup>69</sup> Official website of the Company. – URL: <https://www.lvmhluxuryventures.com/presentation-en/>

– *Long-term business development.* Luxury Ventures wants to contribute to the creation of legendary and cult brands that will serve as benchmarks in the future and assist business owners in long-term business development;

– *Autonomy.* The companies in which Luxury Ventures invests run independently, so the company advises business owners to stick to their principles so that their brands may continue to be original and distinctive in the long run.<sup>70</sup>

Through the complex analysis of Luxury Ventures’ activity, the criteria for investing are the following (see Table 3):

Brand criteria	Desirable, high-potential brands with distinct identities that are designed to meet the needs of clients today and in the future.
Financial criteria	Revenue between €5m and €100m Investments ranging from €5m to €25m+ 5% to 25% shareholdings, mainly through capital increases
Business sector criteria	Beauty & Wellness Selective Retailing Fashion & Accessories Experiential Luxury

**Table 3** – Criteria for investing by Luxury Ventures

The history of the existence of LVMH helps Luxury Ventures on the one hand, to implement its deep knowledge and expertise in what fashion brand to invest, on the other hand, to dedicate itself to its development with the help of excellence, creativity, and innovation.

Luxury Ventures has a huge list of companies, which were invested through purchasing a minority stake on a fashion brand’s development stage.

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<sup>70</sup> Ibid.

During its activity Luxury Ventures has made 11 successful investments<sup>71</sup> (see Table 4):

№	Fashion company	Amount of investment	Year of investment
1	Lusix	\$90M	2022
2	Aimé Leon Dore	Confidential	2022
3	Heat	\$5M	2022
4	Lyst	\$85M	2021
5	Replika	Confidential	2021
6	Hodinkee	\$40M	2020
7	Versed Skincare	Confidential	2020
8	Business of Fashion	Confidential	2019
9	Madhappy	\$1.8M	2019
10	Gabriela Hearst	Confidential	2019
11	Business of Fashion	Confidential	2018

**Table 4** – Timeline of Luxury Ventures’ investments

As it follows from the Table 4 one the recent deal was in 2022, when Luxury Ventures had a small investment in the New York-based fashion and lifestyle company Aimé Leon Dore (hereinafter - ALD).<sup>72</sup> The deal's price is confidential.

According to the agreement, ALD will maintain its autonomous operations and remain located at its New York headquarters. The brand will get assistance and direction from LVMH.<sup>73</sup>

So, Luxury Ventures gives a new start for a brand, providing them with opportunities in the form of finance and other key resources.

<sup>71</sup> LVMH Luxury Ventures. Analysis of its investment activity [Electronic resource]. CBInsights. – URL: <https://app.cbinsights.com/profiles/i/x9vmO/overview>

<sup>72</sup> LVMH acquires minority stake in fashion and lifestyle brand Aimé Leon Dore [Electronic resource]. TFR. – Jan.20, 2022. – URL: <https://tfr.news/news/2022/1/20/lvmh-acquires-minority-stake-in-fashion-and-lifestyle-brand-aim-leon-dore>

<sup>73</sup> Ibid.

Another big player on the market is Kering – a French multinational corporation specialising in luxury goods. It owns the brands Balenciaga, Bottega Veneta, Gucci, Alexander McQueen and Yves Saint Laurent.

In addition, through examples of Luxury Ventures and Kering, we come up with the conclusion that larger fashion companies are increasingly investing in smaller fashion start-ups or platforms that provide sustainability solutions.

In 2013 Kering also purchased a minority stake in Altuzarra. Kering acquires a minority ownership in the Altuzarra brand, ensuring that the firm remains autonomous and under the direction of Joseph Altuzarra and his family.<sup>74</sup>

Kering was delighted to invest in Altuzarra to help this promising fashion house grow and fulfilled its aim to promote fresh creative talent by supporting a young French-American designer to assist speed the growth of his brand.

While Altuzarra is not formally merged into Kering's luxury sector, it has access to Kering's breadth of knowledge and expertise as needed.

The specific proportion of ownership has not been disclosed, but the acquisition allowed the company to launch its first accessory line as well as improve its infrastructure.

Kering gave knowledge and years of experience in developing some of fashion's best names, including Stella McCartney, Alexander McQueen, and, most recently, Christopher Kane, in addition to financial backing.<sup>75</sup>

Moreover, it is so good that Kering invests in and supports brands from the ground up.

Kering successfully continues its investment activity through the years. The current transactions, such as in March 2021 purchase of a 5% stake by global luxury company Kering in Vestiaire Collective – a resale start-up.<sup>76</sup>

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<sup>74</sup>Alexander E. Altuzarra is Kering's new star [Electronic resource]. *Voque*. – Sept.6,2013. – URL: <https://www.vogue.co.uk/article/kering-buys-minority-stake-in-altuzarra>

<sup>75</sup> Ibid.

<sup>76</sup> Salinas L. Kering acquires 5% stake of Vestiaire Collective [Electronic resource]. *Luxiders*. – Mar.1,2021. – URL: <https://luxiders.com/kering-stake-vestiaire-collective/>

With this investment, Kering is targeting a new audience: people that are young and more environmentally conscious as well as providing an additional service to their current clients.

Kering's innovation approach focuses on investing in brands and technology for the next generation of consumers, with a particular emphasis on disruptive business models that allow them to better serve their clients and enhance their performance<sup>77</sup>.

So, such investments in the form of purchasing a minority stake are not made for operating the acquired young fashion brand or fashion start-up. The purchasers post their predictions for the direction of the company and its management team rather than actively trying to run the company by themselves.

The common feature and, of course, beneficial point for target fashion company is that companies that acquire a majority or minority stake in them understand that it is only necessary to direct the invested brands, not to interfere in the brand DNA or remove the lead designers or the founders of a brand from their positions.

In addition, it must be said that mechanism of purchasing a share in a fashion company are not made solely by the investor: they are very responsible for both parties.

The business owner also evaluates the prospective partner. Usually, the negotiation process is quite complicated, time-consuming, and the path to agreements is not always straightforward.

The preliminary communication between the parties builds an initial foundation for the future relationship, and both objective and subjective factors play a role.

The investor wants to make sure that the business has grounds and opportunities for growth and that the company has a "margin of safety" on the one hand, and the possibility of dynamic change on the other. And this largely depends not only on the business concept, but also on the "human factor", i.e. on the presence of a stable team, experienced and loyal top management, and especially on the position of the company's top executives. On the other hand, business owners are trying to find out how comfortable and reliable they will be with a new prospective partner.

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<sup>77</sup> Ibid.



In addition, the parties must come to a common vision of the future development strategy of the retail chain and the tasks on which the raised funds will be spent.

As shown in the examples of recent deals, investors want to invest either in already successful brands in order to further improve brand performance, develop its global presence in the market, then it is best to enter the company by buying a majority stake. Investors are also looking for young brands with great potential for growth, a new vision and rapid adaptation to new trends, such as, for example, ESG. In the latter case, we are talking about large fashion conglomerates, which, through such investments, share their experience and, of course, their financial support.

## **CHAPTER 3. Divestment mechanisms in light of the exit of fashion brands from the Russian market**

### **SECTION 1. Sale of the Russian division to foreign investors**

Sometimes due to the different circumstances we have to observe the divestments mechanisms in the fashion market.

Fashion brands have to choose whether to fully stop operations on the market or to implement another mechanism in order to stay.

At this point we may conclude that big luxury brands prefer to leave or to freeze its operations on the Russian market. These include the Kering group, which owns the luxury brands Gucci, Balenciaga and Yves Saint Laurent, as well as the LVMH group (Louis Vuitton Moet Hennessy) and the Hermes and Chanel companies.

So, as a result much of the Russian M&A market since March this year has been driven by the exit of foreign owners of fashion brands.

For example, last year, the decision to leave the Russian market was also announced by the Spanish retail company Inditex, which includes mass-market brands Zara, Bershka, Pull & Bear, Oysho, Massimo Dutti and other brands.

Others did not stop its operations in the Russian market and decided to choose other methods in order to continue its presence on the market. Some of them decided to sale the Russian division to foreign investors, others – to local management or to large franchisees.

These mechanisms will be analysed in the third charter of the master thesis: *How these processes are organised? How they are functioning in a new reality? What advantages and disadvantages do they have?* This analysis will be based on the recent examples that appeared on the Russian market.

The first section will be devoted to the mechanism of the sale of the Russian division to foreign investors.

This mechanism allows to continue operations in the Russian market and is also linked to an M&A process, but has some complexities in the form of obtaining governmental approval for such transactions, introduced by recent Presidential decrees.

It must be said that such mechanisms cannot be regarded without *new regulations* of such deals, appearing within the sanction's regime.

A special procedure for carrying out (performing) a number of transactions by residents with foreign persons related to "unfriendly" foreign states and entities controlled by such foreign persons was introduced within the framework of the "anti-crisis measures" by the Executive order of the President of the Russian Federation №81 of March 1, 2022 "On additional temporary economic measures to ensure the financial stability of the Russian Federation".<sup>78</sup>

Initially, the special procedure applied to transactions involving shares and real estate, but not to transactions involving shares in limited liability companies.

However, Decree №618 introduced a requirement to obtain permission from the Government Commission for the Control of Foreign Investment in the Russian Federation (hereinafter - the Governmental Commission) for transactions (operations) involving shares in the charter capital of Russian LLCs, if such transactions are concluded between:

- residents and "unfriendly" non-residents (their controlled entities);
- "unfriendly" non-residents;
- "unfriendly" non-residents and other non-residents.<sup>79</sup>

Within the meaning of clause 1 of the Decree, the approval of the Governmental Commission must be obtained not only for the conclusion of a share purchase agreement but also for the execution of any transactions (operations) which directly and/or indirectly entail the establishment, change or termination of rights to own, use or dispose of shares as well as other rights which allow to determine the condition of management and/or carrying on business activities of a Russian LLC. Consequently, depending on the provisions of a particular agreement, approval from the

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<sup>78</sup> Executive order of the President of the Russian Federation No. 81 of March 1, 2022 "On additional temporary economic measures to ensure the financial stability of the Russian Federation" // SPS ConsultantPlus (in Russian).

<sup>79</sup> Presidential Decree No. 618 of 08.09.2022 "On Special Procedure for Execution of Certain Types of Transactions (Operations) between Certain Persons". Entered into force - 08 September 2022. Electronic access: <http://publication.pravo.gov.ru/Document/View/0001202209080027>.

Governmental Commission may be required, including corporate and option agreements, pledges of participatory interests.<sup>80</sup>

From the description of transactions given in the Decree, it can be concluded that option agreements to which the above persons are parties cannot be entered into without authorisation either.

Therefore, until 08.09.2022, the permission of the Governmental Commission for Control of Foreign Investment in the Russian Federation for transactions with LLC shares with a person from a "non-friendly" state was not required.<sup>81</sup>

All these restrictions significantly complicate and delay the process of sale of the Russian divisions of the fashion brands to foreign investors.

For example, in April 2023 Inditex, the parent company of Zara and many other mass-market brands, finally received approval from the Governmental Commission to sell its Russian business to a UAE-based buyer, with some of its former stores to reopen under new branding in April and May.

Clothing chain Inditex (brands Zara, Bershka, Pull and Bear, Massimo Dutti, etc.) has decided to permanently close 269 of its 514 shops in Russia.

In the beginning, it was specified that the assets and rights related to the remaining 245 shops will be transferred to Daher group, with which Inditex has reached an agreement to sell the business in Russia at the end of October 2022. Lately, it was announced that Zara's Russian assets will be bought by Fashion and More Management, based in UAE. The buyer is Fashion and More Management DMCC "with an office in a friendly country". See the timeline of the deal in Table 5.

The conditions of the transaction will allow Inditex Group to keep a significant number of employment in Russia since it involves the transfer of the majority of shop leasing contracts. These facilities, subject to landlord consent, would house stores of brands held by the buying group that are unaffiliated with Inditex.

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<sup>80</sup> Ibid.

<sup>81</sup> Ibid.

Inditex and Fashion and More Management have the possibility of a potential partnership through a franchise agreement if Inditex believes that new conditions allow the Group's brands to return to this market in the future.

Time period	Stage
The end of October 2022	Inditex announced that it had agreed to sell Novaya Moda JSC to the Middle Eastern investment company Daher Group.
January 2023	Fashion and More Management DMCC was registered in the DMCC (Dubai Multi Commodities Center) register of companies.
January - March 2023	The buyers of Inditex's business in Russia is Fashion and More Management DMCC (The business link between Daher Group and Fashion and More Management DMCC cannot be established at the moment).
October 2022 – March 2023	Waiting for approval of the Governmental Commission.
March 2023	The approval of the Governmental Commission has been received.
April – May 2023	Reopening under new branding (MAAG, DUB, ECRU or VILET).

**Table 5** – Timeline of the Inditex - Fashion and More Management DMCC deal

It is difficult for any fashion corporation to stop all activities in a specific market since it involves paralyzing a portion of its structure.

In the case of Inditex in Russia, the decision meant closing the door to its second- largest market after Spain, where it had previously operated through an

omnichannel structure comprised of online retail platforms for its various fashion chains as well as a network of physical shops with over 500 points of sale.<sup>82</sup>

Inditex believes that the provision contained in the first half of 2022 financial statements adequately reflects the impact of the Group's commercial activities ceasing in the Russian Federation.<sup>83</sup> The deal's details have not been published.<sup>84</sup>

The mechanism of sale of the Russian division was also used by Reebok.

In May 2022, Turkish corporation FLO Retailing, which creates brands such as the US Polo Association, Lumberjack, and Reno, bought ownership of Reebok's Russian subsidiary. The purchase resulted in the business acquiring 117 Reebok direct sales locations in Russia. The operations in the Russian market are continued through the company FLO OBUV RU LLC, which has received the right to sell goods under the Reebok brand in Russia.<sup>85</sup>

The same path was chosen by LPP, which is a Polish company that operates five fashion brands: Reserved, Cropp, House, Mohito and Sinsay.

In the beginning it was planned that Far East Services - FZCO from the United Arab Emirates has taken over Russian outlets previously owned by Polish LPP. The record shows that FZCO received 95% of the business, with the remaining 5% going to Anna Pilyugina, general director of LPP S.A. in Russia.

LPP announced in May that it had sold the Russian operation to a Chinese consortium. The parties to the deal agreed that the buyer would not gain the right to utilize the names and trademarks of apparel held by LPP, but would instead acquire the right to sell all of the Russian company's items.<sup>86</sup>

So, this decision allows this fashion brand to continue its staying in the Russian market, but as it was mentioned above with some peculiarities.

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<sup>82</sup> Douglass R. Inditex has sold its Russian business; what are the implications? [Electronic resource]. Fashion united. – Mar.30,2023. – URL:<https://fashionunited.nz/news/business/inditex-has-sold-its-russian-business-what-are-the-implications/2023040726630>

<sup>83</sup> Note sent to the National Securities Market Council [Electronic resource]. Inditex. – Oct. 25, 2022. – URL: <https://www.inditex.com/itxcomweb/en/press/news-detail?contentId=347addfe-2606-46be-b058-40cf67ad2242>

<sup>84</sup> Ibid.

<sup>85</sup> Turkey's FLO in talks to take over Reebok's stores in Russia [Electronic resource]. Reuters. – May,16.2022. – URL: <https://www.reuters.com/markets/deals/turkeys-flo-talks-take-over-reeboks-stores-russia-chairman-2022-05-16/>

<sup>86</sup> Owner of Reserved, Cropp brands decides to sell Russian business [Electronic resource]. Interfax. – Apr.28, 2022. – URL: <https://interfax.com/newsroom/top-stories/78768/>

One of them is a requirement from the Governmental commission about selling shares in Russian companies at a discount of at least 50 percent as one of the mandatory rules for receiving approval from the commission.<sup>87</sup>

This requirement forces the fashion brands to sell its shares at a value that does not actually reflect its actual value, especially when it refers to the sale of the whole Russian division of a foreign fashion brand.<sup>88</sup>

So, this mechanism is not beneficial for fashion companies, but it is better that they are ready to find solutions for staying on the Russian market despite of the amount of measures related to sanctions.

The three examples analysed above are the most recent, from our point of view we will see another examples in the near future.

As aforementioned this mechanism is also connected with the process of getting an approval from the Governmental commission, which takes a lot of time and a huge list of documents and information.

Thus, a fashion company and any other on the market have to provide a detailed description of the significance of the organisation's activities and an assessment of the impact on the technological and industrial sovereignty of the Russian Federation, reflecting the social significance of the business for the Russian economy and the benefits of a positive decision. To disclose information on beneficiaries, beneficial owners, a person exercising control over a party to the transaction as well as carry out a valuation of shares, planning for sale.<sup>89</sup>

It may be concluded that selling a Russian division of international fashion companies is a complicated task, which primarily depends on the Governmental commission's approval. It will not be possible to sell the business without such permission. All in all, from the Inditex example it is seen see that it is possible.

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<sup>87</sup> Extract from the minutes of the meeting of the sub-commission of the Government Commission for the Control of Foreign Investment in the Russian Federation of 22 December 2022 №118/1. – URL: [https://minfin.gov.ru/ru/document?id\\_4=301169-vypiska\\_iz\\_protokola\\_zasedaniya\\_podkomissii\\_pravitelstvennoi\\_komissii\\_po\\_kontrolyu\\_za\\_osushchestvleniem\\_inostrannykh\\_investitsii\\_v\\_rossiiskoi\\_federatsii\\_ot\\_22\\_dekabrya\\_2022\\_goda\\_\\_1181](https://minfin.gov.ru/ru/document?id_4=301169-vypiska_iz_protokola_zasedaniya_podkomissii_pravitelstvennoi_komissii_po_kontrolyu_za_osushchestvleniem_inostrannykh_investitsii_v_rossiiskoi_federatsii_ot_22_dekabrya_2022_goda__1181)

<sup>88</sup> Ibid.

<sup>89</sup> Ibid.

As a result, we deal with the situation when some international retail holdings have announced their final exit from Russia, while others remain in "on pause" mode, leaving their shops closed.

Foreign retailers and companies transferred their Russian units to other legal entities by selling their Russian business to Chinese, Turkish, or Arab holdings, and reopened shops under the same or new brands.

## **SECTION 2. Sale of the fashion company to local management or to large franchisees**

In the first section the sale of the Russian division to foreign investors was discussed, another solution is to carry out a kind of organisational manoeuvre by selling the business in Russia to local management or some large franchisees.

Transferring assets to Russian management is a popular scheme among Western companies in recent months. In some cases, ex-owners put conditions in contracts for return, such as option agreements.

An advantage of this mechanism is that the new owners of the former managers would be able to continue working as they did before, without having to delve further into business processes.

Such a mechanism would prevent conflicts in management, preserving a balance of interests between former and new owners and leaving the latter to buy back the company when the geopolitical situation in the world normalises.

One of example could be a Spanish fashion retailer Mango, but apart from the described mechanism the company also implements another strategy.<sup>90</sup>

Thus, the two of the 55 shops Mango which were directly operating in Russia was transferred to local partners. Others became franchisees as a result of reaching an agreement with several Russian partners.<sup>91</sup>

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<sup>90</sup> Efe. Mango to abandon direct sales in Russia after 23 years [Electronic resource]. Fashion network. –Jun.21,2022. – URL:<https://www.fashionnetwork.com/news/Mango-to-abandon-direct-sales-in-russia-after-23-years-due-to-the-war,1416574.html>

<sup>91</sup> Ibid.



The sale to local management was also implemented by L'Occitane – a French luxury retailer of body, facial, hair, perfume, and home products.<sup>92</sup>

The shares of the company are now owned by the previous General director (31% of shares), and three top managers of the company (each of them owns 23% of shares).

It is important to note that L'Occitane has sold its business in Russia with a buy-back option until 2030. The shares of Russian L'Occitane are pledged to L'Occitane International, a subsidiary of L'Occitane Group. Under the terms of the transfer of the Russian business, the French company will have the right to buy back the shares for five years starting from June 3, 2025.<sup>93</sup>

According to the company statement in June 2022, it takes less than a month to coordinate the transfer of Russian business.<sup>94</sup>

The parties have agreed on a call option: it gives the buyer the right to buy the asset and the seller must sell it if requested. The exercise price of the option will be based on the fair value of the Russian company's business, which will be determined by independent expertise.

Another example is Sephora, owned by LVMH, which has transferred 100% of the shares in its Russian subsidiary to its local General Manager, intending to ensure staff continuity<sup>95</sup>. This activity will now be carried out under the previous "Ile de Beauté" name. This deal is subject to approval by the appropriate authorities, including antitrust regulators.

It is interesting that "Ile de Beauté" is one of Russia's oldest cosmetics and perfumery chains, founded in 2001. It began working with LVMH in 2008, setting up

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<sup>92</sup> Press release. L'Occitane Group to exit Russian operations [Electronic resource]. – May 19, 2022. – URL: [https://group.loccitane.com/sites/default/files/2022-05/220519\\_LOCCITANE%20Russia%20Statement\\_en.pdf](https://group.loccitane.com/sites/default/files/2022-05/220519_LOCCITANE%20Russia%20Statement_en.pdf)

<sup>93</sup> Ibid.

<sup>94</sup> Company Statement. L'OCCITANE Group completes divestiture of Russian operations [Electronic resource] – Jun.3,2022. – URL: [https://group.loccitane.com/sites/default/files/2022-06/220603\\_LOCCITANE%20Russia%20Statement\\_en.pdf](https://group.loccitane.com/sites/default/files/2022-06/220603_LOCCITANE%20Russia%20Statement_en.pdf)

<sup>95</sup> LVMH. Sephora enters into an agreement for the sale of 100% of the shares of its subsidiary in Russia [Electronic resource]. – Jul. 11, 2022. – URL: <https://www.lvmh.com/news-documents/press-releases/sephora-enters-into-an-agreement-for-the-sale-of-100-of-the-shares-of-its-subsiary-in-russia/>

a joint venture where the French group received 45% and an option to increase its stake further.

By 2017, LVMH had bought out the Ile de Beauté chain in its entirety. In 2020, it was announced that Ile de Beauté shops would operate under the Sephora brand.

From our point of view, the mechanism of sale a Russian division to a local management is more convenient, because they can include in the deal the mechanism of buy-back option.

As it was mentioned above, based on Sephora's experience, agreements in a new reality often contain a clause in the SPA itself (or in a separate agreement) allowing the foreign participant to buy back his/her share within a certain period of time and/or in certain circumstances.

The option is then needed to deprive the current buyers of the business of the right to sell to parties other than the current seller (with an obligation to sell the relevant asset upon acceptance of the option by such seller - a foreign person). Fixing the value and other terms of sale is realised by formalising the option - in the form of a separate agreement or by including the option clause in another agreement, such as a share purchase agreement.<sup>96</sup>

In the interest of the seller, in order to minimise the risk of the buyers breaching their obligations to sell back under the option, it is possible to include in agreements between such seller and buyers a buyer liability clause specifying a specific amount of penalty for breach. If, prior to the acceptance of the option within the period specified therein, the purchaser inappropriately disposes of the acquired interest in breach of the option, there is only a chance to invalidate the agreement under which such interest is transferred to a person other than the foreign participant (not the foreign participant) if the court finds that the purchaser of the interest acted in bad faith, including the failure to exercise due diligence in acquiring the interest.<sup>97</sup>

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<sup>96</sup> Seveeva K.V. Option agreements as a way to buy back a business in an unstable economy. //Bulletin of Arbitration Practice. – №5. – 2022.

<sup>97</sup> Ibid.

In order to establish control over the transferred business even after the sale of shares to purchasers, such foreign participant (already former participant) and purchasers may also conclude an agreement under which purchasers, acting already as participants of the company, undertake to exercise their corporate rights in a certain way or to refrain (refuse) from exercising them. This includes voting in a certain manner at the general meeting of the company's shareholders, concerted performance of other actions to manage the company, and refraining from disposing of the shares until certain circumstances occur.<sup>98</sup>

The rules of Russian corporate contract law apply to this agreement (in the legal literature, the construction in question - an agreement with a third party governed by corporate contract provisions - is referred to as a "quasi-corporate agreement").<sup>99</sup>

To minimise the risk of such purchasers breaching their obligations under the contract, it is recommended that liability clauses be included, specifying a specific penalty amount for each breach. If the buyer, as a member of the company, commits a breach of its provisions during the term of such contract, the transaction may be declared invalid by a court, depending on the circumstances and the legal nature of the transaction itself/the breached condition.

A corporate agreement (an agreement on exercise of rights of company's participants, including a "quasi-corporate agreement" concluded with a foreign option holder - a person who is granted the right to accept an offer provided by the option initiator) depending on conditions included into such agreement may also require consent of the Governmental Commission (including in view of Letter №05-06-14RM/99138 of the Ministry of Finance of Russia dated 13.10.2022 with official explanations of the Order).<sup>100</sup>

So, the sale of the stake in whole or in parts to third parties, more often to management, where the foreign seller already wants the highest possible price. Such a

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<sup>98</sup> Seveeva K.V. Involvement of Involved Persons in Execution of Option Agreements Mediating Transfer of Rights to Shares (Stakes) in Share Capital of Business Entities // Legislation. – № 4. – 2022. – p. 24 - 31.

<sup>99</sup> Ibid.

<sup>100</sup> Letter № 05-06-14RM/99138 of the Ministry of Finance of Russia dated 13.10.2022 with official explanations of the Order // SPS ConsultantPlus (in Russ).

price is often not paid immediately by the buyer, in which case the share sold may remain in escrow with the seller until it is paid in full by the buyer.<sup>101</sup> Whether the company will retain the trademark when the foreign owner leaves, if it was also owned by foreign persons, depends on whether they agree to a license agreement or a franchise agreement.

In this buy-sell scenario, particular attention must be paid to valuing the asset and establishing its value and, for the buyer, also to conducting due diligence on the company to be acquired.

To conclude, current transactions related to Russian subsidiaries of fashion and luxury cosmetics brands are considerably more complicated and require approval from the Governmental Commission.

If the company decided to make divestment mechanisms on the Russian market, the practice shows that fashion companies mostly choose between the sale of a Russian division to foreign investors or the sale to local management or large franchisees.

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<sup>101</sup> Ibid.

## CONCLUSION

The primary goal of this master thesis was to comprehensively analyse all specifics of deals in the fashion market. As a result, we may see that mostly these processes are based on M&A.

As has been seen, the M&A deal process is drawn out and involves several factors. In the world of large fashion firms, it is one of the most suited company development mechanisms.

In most circumstances, the outcomes of M&A will result in synergy, increased wealth, and opportunity capitalization. As a result, there are more and more M&A transactions in the fashion industry every year.

When M&A deals are employed in the fashion business, it is not sufficient to take into account merely the standard M&A content and method. Fashion designs serve as intellectual property, and as such, the position of the lead designer, future integration plan, and even the history of the target firm must all be taken into consideration during the M&A process. If these factors are not sufficiently considered, a deal may not result in successful close and expected outcomes.

Then we face the situation that primary goals of making an investment in a fashion company may differ.

Some fashion companies, which have been on the market for quite a long time, have good financial indicators, want more development and strengthening their position in other international markets. In this case, the process of purchasing a majority stake helps both a vendor and a purchaser.

Purchasing a majority stake by an investment firm is helpful for bringing in more money and investment to achieve global growth in foreign markets. If a majority stake is bought by a retailer it will be helpful for a fashion company to expand sales channels. Purchasing a majority stake in a fashion online platform is helpful for the brands that want to provide a dynamic and engaging online environment. If a majority stake is bought by a brand management firm it can be useful for the fashion companies that want to improve their brand with the help of a marketing specialist, for example, to change marketing strategy.

Through analysis of the recent deals in the fashion market it is shown that there are so many companies, specializing on such purposes. They have a good expertise and deep knowledge of how to help a fashion brand.

In addition, regarding the purchase of a majority stake in a fashion company it is crucial that the brand's creator or designer remain a key player in business operations, assisting it in maintaining its distinct fashion DNA and preserving its historical values and peculiarities. The new majority shareholder should focus only on areas where the brand can be improved based on its specialisation and expertise.

A different situation is with the purchase of a minority stake. Here we can observe how the big players in the market, such as Luxury Ventures as a division of LVMH and Kering are looking for investments in such form. They have their criterion for investments.

According to the sustainability and active development of different fashion start-ups and young fashion brands, it is quite wide spreading and popular to make such investments.

It is important to note that the acquired young fashion brand or fashion start-up is not operated through investments in the form of buying minority ownership. Instead of actively trying to operate the firm on their own, the purchasers just express their forecasts for the path of the company and its management team.

Sometimes the fashion market is facing divestment mechanisms as it has happened in the Russian fashion market. Global fashion brands have to choose how they must behave themselves in the current situation.

Some companies were selling their Russian subsidiaries to foreign investors, others – to local management or large franchisees. These mechanisms have their own advantages and disadvantages, but they are also closely connected with the current limitations of such transactions.

Transactions involving Russian subsidiaries of premium fashion and cosmetics businesses are currently far more difficult and need approval of Governmental commission.

These restrictions also oblige foreign companies to sell their businesses at an undervalue from the market price, which also affects current operations.

However, it is good that many companies include a buy-back option in the deal, which will allow companies to return to the Russian market.

The main conclusion is that the M&A process will be a crucial component of the development of the fashion market. On the one hand, having a fairly large list of requirements, duration and dependence on constantly changing legislation, on the other hand, this mechanism allows the parties to the transaction to adjust it to their needs and achieve exactly the results they have planned, whether it's an investment or a divestment mechanism.

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