Read carefully the questions and adequately justify your answers. Consultation of class or other materials is not allowed. The use of simple, non-alphanumeric, non-programmable calculators is permitted, including scientific calculators. The use of graphing calculators is not allowed. Answer Group 1, Group 2, and Group 3 on three separate sheets.

Adapted from:
https://digital.hbs.edu/platform-digit/submission/farfetch-tackling-the-online-luxury-fashion-market/
https://www.digitalcommerce360.com/2018/03/01/flush-with-cash-farfetch-steps-up-us-marketing-for-its-online-luxury-mall/

Farfetch prides itself on being the only online luxury fashion platform at scale. Leading up to its IPO in 2018 and having raised 885 million dollars with this operation, it has amassed impressive growth and continues to do so till today in the large USD 300 billion luxury fashion industry. Started by José Neves, Farfetch now has two million active users in 190 countries engaging with 500 brands and 700 boutiques. Brands include the likes of Chanel and Saint Laurent, whilst boutiques include high-end retailers such as Harrods and Harvey Nichols. So how have they become so successful?

On the supply side, they offer traditional brick-and-mortar boutiques a strong online presence that they typically lack (or poorly execute on) and access to a large number of customers. They also give brands more access to the younger generations (millennials and gen-z) who increasingly prefer to shop online. On the demand side, consumers are offered a wide but curated selection of goods from the best brands, superior customer service (i.e. data-driven marketing, logistics, care), convenience, and an element of discovery (thrifting through pages to find hidden gems). The more users that join, the more brands that sign up, and vice-versa.

Farfetch is known for its quick deliveries in certain major geographies, including London and New York. They operate same-day deliveries in 19 cities. They also offer returns at no charge for customers. Farfetch has become a common name in the industry for both brands and consumers of luxury fashion. They are synonymous with luxury, selective, reliable, customer-centric, fast, etc. The platform continues to innovate on both sides of the platform to remain relevant. On the supplier side, they offer platform solutions that help brands develop full end-to-end digital experiences, which include opening digital stores or setting up WeChat stores. On the demand side, they recently launched *Second Life*, an initiative where users can sell back second-hand goods to Farfetch for credit to use on the website. This was done to appeal towards the trend of buying sustainably. Farfetch monetizes the platform on the supply side by charging the brands a total of 25% on the sale of each good, with added 8% if retailers wish to outsource order fulfillment to Farfetch. Over 70% of the company's revenue comes from the sales commission.

Farfetch has been able to attract a strong customer segment of young men and women that spend an average order size of 550-650 USD consistently. In 2018, Farfetch crossed the 2 million customer threshold — and it's moving aggressively to keep growing, especially in the United States and China. John Veichmanis, chief marketing officer of Farfetch, says the prime target are millennials, the consumers in their 20s and 30s, who make up nearly 60% of Farfetch's customers. According to Wikipedia, Millennials have been described as the first global generation and the first generation of digital natives. Between the 1990s and the 2010s, people from the developing world became increasingly well educated, a factor that boosted economic growth in these countries. Millennials across the world have suffered significant economic disruption since starting their working lives; many faced high levels of youth unemployment during their early years in the labour market.

John Veichmains says the focus of Farfetch platform is on reaching shoppers in "micro-moments" when they're glancing on their smartphones throughout the day to check out an Instagram post, tweet or email. Whereas years ago, luxury shoppers may have spent an hour reading a long article in a magazine like Vogue, that's not how Farfetch shoppers follow trends today, he says. "Our focus is to find people who love luxury and invest our marketing dollars behind those people," he says. "And that's fueled by the quality of data we have."

Farfetch has strong relationships with the brands and boutiques they showcase on their website. Not only do they provide value-added solutions for their partners but they engage in collaborative seminars, creating a community feel around the network. More importantly, they have locked in 98% of their retailers with exclusivity contracts. Farfetch operates a business model where they do not have to own any inventory. Instead they have an efficient back-end technology system that sources the desired product from around the world and makes arrangements with the respective retailer / brand to complete the order. Despite growing so quickly, they have also been able to keep up with front-end technology needs in dealing with superior user experience.

GROUP 1 (7 points)

1. Based on market segmentation, how do you characterize Fartetch's target segments? (4)

Theory	Application
Characterize segmentation, and segmentation variables (15%) Explain what target segments are (5%)	Explain that Farfetch is not mass-market and is focused on particular segments (15%): In the response, may first identify the different segments based on segmentation variables and then identify target, or characterize directly Farfetch market segments considering the segmentation variables: Farfetch market segments Geographic (15%): quite global company, with two million active users in 190 countries. So, no specific geographic target segment Socio-demographic (20%) younger generations 20-30 (millennials and gen-z), both men and women increasingly well-educated affluent consumers who can afford luxury goods Psychographic (15%) Could be a mix of experiencers and innovators Global generation (innovators) Like an element of discovery (experiencers) Like to follow trends (experiencers) Behavioral (15%) Consumers who like to shop online Looking for convenience High average order size

2. How do you characterize Farfetch's positioning? (3)

Theory	**Application**
Explain what positioning is, points of difference and points of parity (20%) Position statement Among (*target market*), our offering is the brand of (*frame of reference*) that (*point of difference*) because (*reason to believe*).	One possible example, but not the only one: Among *young and affluent digital natives*, Farfetch is the *online retailer of luxury goods* that offers *a wide but curated selection of goods from the best brands, superior customer service, convenience, and an element of discovery* because of their *partnerships with best luxury brands and boutiques, their efficient back-end technology system that sources the desired product from around the world, and their front-end technology for superior user experience.* Points of difference: wide but curated selection of goods from the best brands, superior customer service, convenience, element of discovery Points of parity Online retail service Home delivery Return service …

GROUP 2 (6 points)

3. Based on the information provided in the text, characterize in as much detail as possible the product-market fit for Farfetch's business model. (3 points)

Customer segments: (20%)
- General users, mainly Millennials – Over two million active users in 190 countries
- Brands and traditional brick-and-mortar boutiques of luxury fashion – 500 brands and 700 boutiques

Value proposition: (30%)
- (product) Online luxury fashion platform at scale
  - Luxury, selective, reliable, customer-centric, fast, etc.
- Offer for general customers:
  - wide but curated selection of goods from the best brands;
  - superior customer service;
  - convenience;
  - element of discovery;
  - quick deliveries;
  - returns at no charge;
  - Second Life (initiative where users can sell back second-hand goods to Farfetch for credit to use) – Appeal towards the trend of buying sustainably
- Offer for brands and boutiques:
  - Strong online presence that they typically lack (or poorly execute on)
  - Access to a large number of customers – mainly to the younger generations
  - Platform solutions that help develop full end-to-end digital experiences – including opening digital stores or setting up WeChat stores

4. What are the Farfetch's key activities and key resources mentioned in the text, and how do they align with the product-market fit? (3 points)

Key activities: (30%)
- Quick deliveries in certain major geographies – operate same-day deliveries in 19 cities
  Alignment with product-market fit: to offer quick deliveries to general customers
- Platform innovation on both sides of the platform to remain relevant
  Alignment with product-market fit: to offer online presence and new platform solutions for brands and boutiques, and to offer new solutions such as Second Life and other functionalities for general customers
- Data management (for quality of data)
  Alignment with product-market fit: to ensure good relationship with customers

Key resources: (20%)
- Efficient back-end technology system – source the desired product and make arrangements with respective brand or retailer to complete the order
  Alignment with product-market fit: to ensure convenience, quick delivery to general customers and access to younger generations for brands and boutiques
- Keep up with front-end technology needs
  Alignment with product-market fit: to ensure superior user experience

GROUP 3 (7 points)

5. In 2018, for the first time, Farfetch sold their shares in the initial public offering (IPO) raising USD 885 million in this operation, increasing their equity. In the next page you can find some financial information of Farfetch before and after the IPO (real values, in thousands $).

INCOME STATEMENT

	2017	2018
Sales	385 966	602 384
Cost of goods sold	-1 812	-303 934
Gross Profit	**204 766**	**298 450**
Selling, general and administrative expenses	-295 960	-471 766
EBITDA	**-91 194**	**-173 316**
Net Income	**-112 275**	**-155 575**

BALANCE SHEET

	2017	2018
Current assets	452 792	1 199 410
Non-current assets	110 266	151 983
Total assets	**563 058**	**1 351 393**
Current liabilities	155 890	194 158
Non-current liabilities	10 265	28 804
Total liabilities	**166 155**	**222 962**
Equity	**396 903**	**1 128 431**

FINANCIAL RATIOS

Category	Ratio	2017	2018
Profitability	$Return\ on\ assets\ (ROA) = \frac{Net\ income}{Total\ assets}$		
	$Return\ on\ equity\ (ROE) = \frac{Net\ income}{Equity}$		
Efficiency	$Asset\ turnover = \frac{Sales}{Total\ assets}$		
Liquidity	$Current\ ratio = \frac{Current\ assets}{Current\ liabilities}$		
Leverage	$Debt\ to\ equity = \frac{Total\ liabilities}{Equity}$		

Based on the above information, calculate the financial ratios for 2017 and 2018 and perform a financial analysis of Farfetch based on the sales growth and the calculated financial ratios. Considering your analysis would you invest in Farfetch?

1. Calculating the ratios (36% ratios + sales growth)

Category	Ratio	2017	2018
Profitability	$Return\ on\ assets\ (ROA) = \frac{Net\ income}{Total\ assets}$	-19,9%	-11,5%
	$Return\ on\ equity\ (ROE) = \frac{Net\ income}{Equity}$	-28,3%	-13,8%
Efficiency	$Asset\ turnover = \frac{Sales}{Total\ assets}$	68,5%	44,6%
Liquidity	$Current\ ratio = \frac{Current\ assets}{Current\ liabilities}$	2,90	6,18
Leverage	$Debt\ to\ equity = \frac{Total\ liabilities}{Equity}$	41,9%	19,8%

Sales growth: 56%

2. Analysis: recognize the sales growth but negative net income (7%) + recognize the impact of the IPO on the balance sheet and on the ratios (7%) + define each type of ratio (14%) + analyze the evolution of each ratio (21%) + make and argue a decision (14%).

Example of possible answer:

An analysis of Farfetch's accounts shows that despite sales increasing by 56% from 2017 to 2018, its net income remains negative, with even greater losses in 2018.
In 2018, the company sold their shares in the initial public offering (IPO) raising USD 885 million in this operation. This capital inflow had repercussions on the balance sheet accounts through a considerable increase in current assets and equity. Likewise, the analyzed ratios were affected by this capital inflow from the shareholders. When comparing 2018 to 2017, the company's short-term liquidity improved (current ratio), also increasing the part of its operations financed through equity rather than debt (debt-to-equity ratio). Despite remaining negative, profitability ratios improved with the inflow of capital (ROA and ROE). The growth in sales did not keep up with the growth in assets, with the efficiency ratio worsening (asset turnover ratio).
ROA indicates a company's profitability in relation to its total assets and is used to determine how efficiently a company uses its assets to generate a profit. In this case the ROA is negative, because the net income is

also negative. However, despite net income worsening in 2018, ROA improved compared to 2017. A negative ROA does not mean the company is running out of money. In 2018, with the cash inflow of USD 885 million, the company may have had positive cash flows (in this case we do not have data on cash flows to confirm), which is not reflected in the ROA.

ROE analysis allows to understand the % of profit that a company generates from its shareholders' equity. This value is also negative, but following the same trend of ROA improvement. The main difference between ROA and ROE is that ROA accounts for a company's debt while ROE does not, as it only measures a company's return on equity, leaving out its liabilities. Therefore, the more leverage and debt a company takes on, the higher ROE relative to ROA will be. In 2017, ROE is much higher that ROA, which means the company takes on more debt. This difference is reduced in 2018, with the company's financing through equity, with the ROE continuing to be higher than the ROA.

The **asset turnover ratio** measures the value of a company's sales relative to the value of its assets. It can be used as an indicator of the efficiency with which a company is using its assets to generate sales. The higher the asset turnover ratio, the more efficient a company is at generating sales from its assets. In this case, this ratio has decreased from 2017 to 2018, which could mean a loss of efficiency in using its assets to generate sales. This decrease is largely due to the 140% increase in total assets when sales only grew 56%.

The **current ratio** measures the company's ability to cover its short-term debt with its current assets. The company's liquidity increased significantly from 2017 to 2018, given the inflow of capital into the company through the IPO.

The **debt-to-equity ratio** compares a company's total liabilities to its shareholder equity and can be used to evaluate how much leverage a company is using. A high debt-to-equity ratio is often associated with high risk, meaning that a company has been aggressive in financing its growth with debt. In the case of Farfetch, this ratio has high values, having decreased considerably from 2017 to 2018, given the inflow of capital into the company through the IPO.

Taking into consideration this analysis I would/would not invest on Farfetch because…