SPEED-TO-MARKET

DIFFERENTIATE AND COORDINATE: HOW TO ACHIEVE THAT CRUCIAL ADVANTAGE

- Speed to market becomes crucial for apparel retailers' competitive advantage as they respond more quickly to changing fashion trends.
- Speed to market is often hindered by inefficiencies in the supply chain.
- Companies adopt different strategies to improve speed to market, including the diversification of sourcing geographies and the adoption of initiatives aimed at improving coordination among suppliers.
- There is no "one size fits all" strategy when it comes to improving speed to market; companies need to assess their specific circumstances and act accordingly.

DEBORAH WEINSWIG
EXECUTIVE DIRECTOR –
HEAD OF GLOBAL RETAIL & TECHNOLOGY
FUNG BUSINESS INTELLIGENCE CENTRE
DEBORAHWEINSWIG@FUNG1937.COM
US: 646.839.7017
HK: 852.6119.1779
CHN: 86.186.1420.3016

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Speed to market (STM) is becoming a necessity for apparel retailers and manufacturers in order to stay competitive. E-commerce and fast fashion have changed shopping habits and made consumers more demanding in terms of what they want—which is *more*—and when they want it—which is *now*. As a result, STM has risen as the main concern for apparel retailers, overtaking cost considerations when it comes to sourcing.

This report analyzes the STM challenges retailers face and the strategies they are adopting, or planning to adopt, in order to speed up their supply chain to better respond to the demands of the current fast-paced market.

STM Becomes More Important than Cost

The market has shifted, and STM is now crucial for competitive advantage. Demand for increased STM has become the top market pressure for apparel retailers, according to the 2015–2016 edition of Deloitte's *Private Label Sourcing Survey*. In this year's survey, STM overtook cost considerations as retailers' main concern, a significant shift from the last survey, in which respondents listed factors such as raw materials, energy and labor costs as their primary concerns.

STM has become even more important as fashion cycles have shortened across the industry. Trends in fashion change rapidly, and consumers expect to find new collections in stores more frequently. The time from the emergence of a trend to its mass dissemination has shrunk considerably, from one year to three to five weeks, according to The Boston Consulting Group's *Apparel at a Crossroads* report. Given that there is so much information on the latest trends available online now, the time it takes for clothing lines to go out of fashion is significantly shorter than it used to be.

In this fast-paced environment, apparel retailers must consider what factors are slowing down their STM, and what strategies they can adopt to speed it up, in order to remain competitive.

Lack of Coordination Affects STM

Supply chains involve multiple vendors, which are often located in different and distant geographies. Effective coordination of all the parts in the chain can be difficult, and a lack of collaboration between the participants can significantly slow STM. Design and development process inefficiencies are often one of the main culprits. Sending samples from a producer to a designer, for example, lengthens development time. And most companies require at least two iterations at the sample stage, according to the *Excellence in Sourcing Research Study* published by *Apparel* magazine. The report notes that a lack of coordination within distribution center processing, transportation and network strategy can also slow STM.

According to sourcing-industry contacts interviewed by FBIC Global Retail & Technology, labeling, packaging, ticketing issues and delays on customers' orders are among the other factors that can negatively impact STM. In other words, it is crucial that retailers effectively coordinate the suppliers of complementary items in order to deliver goods quickly to their final customers.

Closer Sourcing Speeds Up the Supply Chain

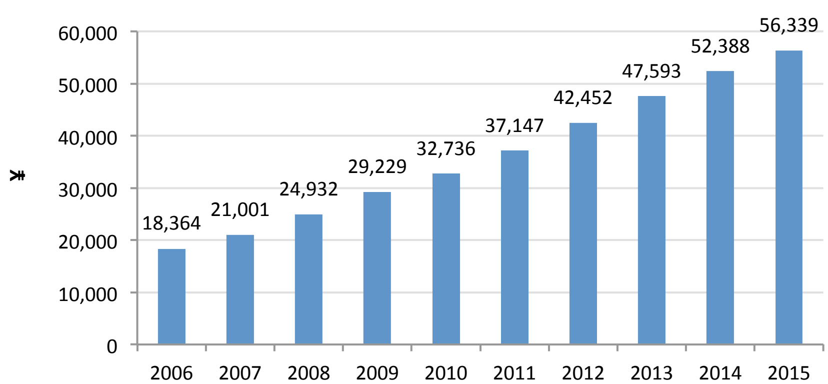
Companies are revising their sourcing strategies in order to speed up their supply chain and STM. Sourcing closer to the final customer's market—onshoring and nearshoring—is one important approach many companies are adopting.

Onshoring Becomes Part of the STM Strategy

Onshoring—sourcing production from domestic vendors—and nearshoring—sourcing from producers located in countries closer to the final customer's market—are becoming options that Western apparel firms are looking at in order to cut transportation time and significantly improve their STM.

Globalization made offshoring—sourcing products in countries with low labor costs—the norm for Western apparel firms. However, sourcing domestically or closer to the final customer's market is becoming economically viable again as wages in traditional outsourcing countries are going up, eroding the competitive advantage that lower labor costs formerly brought to the table. In urban China, for instance, wages have increased by more than 200% in the last 10 years.

Figure 1. Average Annual Wage for Urban Workers in China

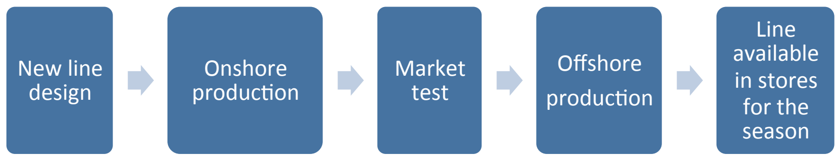


Source: National Bureau of Statistics of China/Trading Economics

In response to the rising importance of STM, and with wages rising in sourcing countries, retailers surveyed by Deloitte indicated that the top strategies they plan to adopt are reshoring production and diversifying manufacturing sources.

Two major British retailers are now using domestic manufacturing for experimental lines, FBIC Global Retail & Technology has learned. The strategy, summarized in Figure 2, consists of sourcing new lines initially from domestic manufacturers, despite the higher production cost of doing so. Retailers then test the market by selling a given line under cost (at the same price it would charge if it had been produced in a country with a low manufacturing cost) for a set period of time. If the line proves successful, the production is outsourced overseas to markets with low labor costs.

Figure 2. Experimental Lines: Testing the Market Through Onshoring



Source: FBIC Global Retail & Technology

Different Countries, Different Competitive Advantages

As the example of experimental lines shows, Western firms are not completely abandoning offshore manufacturing in favor of domestic production or nearshoring. Different countries retain distinct competitive advantages that make them attractive as a sourcing destination for retailers that aim to develop a well-diversified sourcing strategy.

Onshore and Nearshore Markets Increase Their Appeal…

Sourcing from domestic markets, however, delivers several advantages:

- **Speed of delivery:** The proximity of production to the end customer's market minimizes time spent transporting materials and finished goods.
- **Easier to control the supply chain:** Proximity also makes it easier for a company to control its vendors, as they are local and, therefore, more likely to share similarities such as language, business regulations and time zone.
- **Brand image:** "Made in…" domestic market product is appreciated by domestic consumers and by consumers in emerging markets such as China, where Western brands that are able to display their authenticity are particularly sought after, according to sourcing experts.

Nearshore markets provide faster STM thanks to proximity to the final customer's market, but usually with lower production costs compared to onshore manufacturing. The vendors along the supply chain are normally based in comparatively cheap, neighboring countries. For example, if a company's core market is mainly in the US, the firm might find it cheaper to source fashion-sensitive garments from manufacturers in Mexico rather than from domestic vendors.

…but Offshore Markets Remain Attractive

Offshore countries still remain central to Western companies' sourcing strategies. While domestic production is becoming economically viable for more fashion-sensitive garments, offshore sourcing, particularly for standard, more predictable items, continues to deliver advantages. These include:

- **Low-cost production:** Despite rising wages, offshore production continues to be cheaper. For example, the average monthly salary in Vietnam was just US$225.50 (as of March 2015), compared to US$4,344.90 in Germany (as of December 2014), according to Trading Economics.
- **Reliability:** Over the years, offshore producers in markets such as China have created a highly reliable network of suppliers for foreign companies. These suppliers are often capable of delivering quality and flexibility that is unmatched by other manufacturing countries.

The attractiveness of the different offshore countries can change over time. For instance, as noted above, China is clearly no longer regarded as a cheap offshore production base. However, according to sourcing experts interviewed by FBIC Global Retail & Technology, Vietnam is becoming increasingly attractive thanks to its ability to handle large orders, its technically skilled workforce and its favorable regulatory regime for foreign investors. On the other hand, traditional outsourcing destinations such as Bangladesh are losing out, mainly due to security concerns, political instability, bureaucracy and a generally difficult business environment. (Bangladesh ranks number 173 out of 189 countries in the World Bank's Ease of Doing Business ranking. Vietnam, in comparison, ranks number 78.)

A Closer, More Collaborative Relationship with Suppliers

Employing different suppliers for different stages of the product cycle means that fostering coordination and collaboration within the supply chain is even more important, in order to avoid inefficiencies. This can often be achieved through vertical approaches in which the retailer at the top of the supply chain tightens control over the other parts of the system. The retailer thus encourages suppliers to deliver products on time and to the required standard, preventing delays and stock returns. Vertical approaches include:

- **Quality assurance programs:** Implementing initiatives such as more rigorous supplier selection and frequent visits to suppliers' facilities.
- **Better vendor management:** Implementing supply chain management systems that can monitor vendors' performance, including creating supplier scorecards and identifying areas for improvement.
- **Work-in-progress tracking:** Implementing a system that allows the company to view the current status of the production and distribution cycle at any time, making the supply chain more transparent, which allows easier identification of any potential causes of delays.

DEBORAH WEINSWIG, EXECUTIVE DIRECTOR–HEAD OF GLOBAL RETAIL & TECHNOLOGY
DEBORAHWEINSWIG@FUNG1937.COM US: 917.655.6790 HK: 852.6119.1779 CN: 86.186.1420.3016

Another way to foster collaboration and coordination within the supply chain is through horizontal approaches in which retailers more actively involve their suppliers. These can often result in better coordination throughout the supply chain and in improved STM. Horizontal approaches include:

- **Fostering R&D and design collaboration:** Involving suppliers in the design stage can help a company get the manufacturer's input on issues related to the production of the sample, and then address them before mass production starts. Design collaboration that employs 3D visualization—a technology that allows remotely located vendors to see prototypes in 3D on computer screens—can help prevent unnecessary sample reiterations.

- **Increasing interaction occasions:** More interaction within the supply chain encourages communication and collaboration among all players. Regular conference calls between a company and its suppliers to discuss plans, progress and potential issues can be a simple and cost-effective way to improve collaboration.

Combining vertical and horizontal approaches can help retailers maximize STM. By implementing vertical systems, a retailer—or a company involved in supply chain management on behalf of the retailer—can manage every supplier within the supply chain at any time, making it possible for the firm to ensure a consistent standard of production and spot issues as soon as they occur.

The horizontal approach is a useful complement to such hierarchical control. And according to the sourcing industry contacts we interviewed, collaboration within the supply chain is paramount to optimizing STM. A collaborative horizontal approach allows retailers to more effectively coordinate the various parts of the supply chain by strengthening synergies among suppliers.

Vertical Integration: Not for Everyone

A number of large apparel retailers use vertical integration, but the term's definition is quite loose. It does not necessarily imply that a company owns its entire supply chain, from production facilities to retail outlets. Usually, vertical integration means that a retailer owns its retail outlets and exerts strong control over the other parts of the supply chain, and that it directly selects its own vendors, as opposed to using sourcing firms to select them.

Inditex and Esprit are examples of large fashion retail firms that have embraced vertical integration systems in a bid to improve STM. Inditex has used vertical integration as a core component of its business model since its early days, but Esprit started to vertically integrate only recently, partially in response to a decline in sales.

Esprit's sales revenues declined from HK$34.4 billion (US$4.4 billion) in 2009 to HK$24.2 billion (US$3.1 billion) in 2014—a drop of 30%. In response, in July 2014, the company introduced a vertical integration model to reduce product development lead time and simplify its supply chain. The strategy included the centralization of buying and merchandising, a leaner supply chain to reduce complexity, a more rigorous supplier selection process that favored the best-performing vendors, and faster product development, with a lead time of two to three months.

While it is still too early to assess whether vertical integration has improved Esprit's competitiveness, it certainly will not be enough to overcome the company's sales decline, at least in the short run, as comparable store sales continued to decline, by 7%, in fiscal year 2015.

The fact that large retailers such as Inditex and Esprit have vertically integrated does not imply that this is the only way for retailers to compete in the current business environment. Most companies have not adopted vertical integration, and find that their best option is to capitalize on the expertise and economies of scale that partner sourcing companies provide—this ultimately helps them improve STM and reduce costs.

No One-Size-Fits-All Solution

When it comes to strategies to increase STM, there is no single solution that can be universally applied. According to its specific circumstances, a retailer might find it advantageous to increase its control over and collaboration with existing suppliers, diversify its vendors (by onshoring, nearshoring or offshoring), or gain direct control of its supply chain thorough vertical integration. In choosing the right strategic path, retailers should ask themselves the following questions about their supply chain:

- Can it live up to the current challenges?
- Can it take advantage of market opportunities?
- Are the resources employed fully optimized?
- Is there any scope for further improvement?

Whichever strategy allows a retailer to respond positively and address these crucial questions is the right one for it to adopt in order to gain competitive advantage and thrive in today's fashion industry.

Deborah Weinswig, CPA
Executive Director—Head of Global Retail & Technology
Fung Business Intelligence Centre
New York: 917.655.6790
Hong Kong: 852.6119.1779
deborahweinswig@fung1937.com

Filippo Battaini
filippobattaini@fung1937.com

John Harmon, CFA
johnharmon@fung1937.com

Aragorn Ho
aragornho@fung1937.com

John Mercer
johnmercer@fung1937.com

Shoshana Pollack
shoshanapollack@fung1937.com

Kiril Popov
kirilpopov@fung1937.com

Jing Wang
jingwang@fung1937.com

Steven Winnick
stevenwinnick@fung1937.com

Eddie Wong
eddiewong@Fung1937.com

HONG KONG:
10th Floor, LiFung Tower
888 Cheung Sha Wan Road, Kowloon
Hong Kong
Tel: 852 2300 2470

LONDON:
242-246 Marylebone Road
London, NW1 6JQ
United Kingdom
Tel: 44 (0)20 7616 8988

NEW YORK:
1359 Broadway, 9th Floor
New York, NY 10018
Tel: 646 839 7017

FBICGROUP.COM