White Paper

Four Steps to Building a Branded Apparel Competitive Edge

Executive Summary

Several key trends—such as increasing dominance of mass merchants, growing focus on private labels and the emergence of agile vertically-integrated retailers—have pressured branded manufacturers and dramatically reshaped the industry. These trends are pushing already thin margins even lower and forcing brands to accelerate sell-in and sell-through at the retailers. Branded manufacturers must evolve their supply chain processes to more profitably compete in this dynamic market.

This white paper examines several key factors that have shaped the apparel industry and presents four steps to achieve improved planning at the store level, a greater ability to react to in-season replenishment signals and a streamlined sales and operations planning [S&OP] process.

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Technology and supply chain connectivity enable new concepts to go from the drawing board to the sales floor in under one month.

Trends and Pressures Faced by Brand Owners

Apparel retailing has changed enormously. For instance, in the US, the 50 largest companies out of 100,000 total clothing stores account for 65 percent of revenue. Mass merchant discounters [Walmart, Target, Kohl's...], vertically-integrated retailers such as The Gap and The Limited, and "fast fashion" retailers such as Zara and Hennes & Mauritz [H&M], have all contributed to a seismic shift in the traditional balance of power between manufacturers and retailers.

In addition to fickle consumer buying behavior, other important trends could prove troubling to branded manufacturers:

- The growing dominance of mass merchants
- Increased emphasis on retail private labeling
- Lean apparel retailers accelerating the concept-to-cash cycle
- Increasingly complex sourcing options
- Proliferating "sub-seasons"

Dominance of Mass Merchants

Suburban malls were traditionally a safe haven for department stores and specialty merchants. This has changed in recent years. As mass merchants open new locations at local and mall-based sites across the country, discounters are predicted to take over many anchor mall spots within a few years. Target, the number two discount chain in the US, has moved into malls, and Walmart has begun adopting a new range of store formats, including a more compact 80,000 square foot version with no lawn and garden center.

In the US, the 50 largest companies out of 100,000 total clothing stores account for 65 percent of total apparel revenue.

While the addition of mass merchants in malls may drive overall traffic, there is a real threat that their growth in the apparel segments will cannibalize apparel sales at specialty and department stores. The assortments and price points may not directly compete with upscale retailers, but mass merchants have clearly gained momentum in apparel categories. The percentage of apparel sales from discounters has grown, and according to analysts, this has been at the expense of specialty merchants and department stores. History has shown that as mass merchants gain momentum in consumer goods categories, retail prices and margins for those products decline, with the manufacturers taking the brunt of the impact.

Increased Focus on Private Labels

Retailers are pursuing increased sales and profitability by creating and selling more private label products. This trend has been accelerated by brand owners themselves, who have shed owned-and-operated manufacturing facilities in favor of full-package outsource solutions. Today, access to factory groups around the world is wide open, with these sources producing finished goods for premium brands and private labels under the same roof. The balance of power has shifted significantly toward retailers, who are able to attract the premium prices and customer loyalty that comes with quality house brands that offer a unique style.

From department stores such as Federated and May to mass merchants like Walmart and Target, retailers are increasing their private label programs. Private label brands provide wider profit margins, and so command better floor space, more prominent promotions, and, most importantly, growing retail commitment to build a stronger brand image.

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Branded apparel manufacturers are also creating sub-brands in order to capture some of the volume of mass merchants while maintaining the integrity of—and control over—their premium brands. For some, licensing core brands to mass merchant partners has caused perception problems, so licenses have not been renewed in order to regain firm control of the line. By creating and licensing sub-brands [good, better, and best], the company maintains control over signature lines and ensures that brand equity doesn't erode.

As private label grows, there is a counterbalancing trend by some retailers to create exclusive deals with major brands, effectively creating branded house labels that compete with the retailer's own house labels. Now, both branded apparel companies and retailers are attempting to differentiate their product assortments from the competition, respond to market trends in a manner consistent with the brand and deepen consumer loyalty.

Emergence of Agile Vertical Retailers

In recent years, innovative vertically-integrated retailers have redefined the retail apparel supply chain using a business model that stresses speed and integration of store operations with design, sourcing and manufacturing operations. Technology helps the retailer quickly identify trends and items that sell or don't sell at a store level, and then the appropriate sourcing, manufacturing and replenishment decisions are made to maximize sell-through, minimize stock-outs and drive overall in-season performance.

This model, exemplified by the Spain-based Zara store chain, uses small-batch manufacturing and holds strategic inventory in fabrics rather than finished goods, thus increasing flexibility and speed-to-market. Technology and supply chain connectivity enable new concepts to go from the drawing board to the sales floor in under one month, or to have hot-selling items replenished to stores the next day.

This approach has shattered some long-held industry perceptions. Identifying the latest hot fashion items to emulate, then sourcing to quick-turnaround local manufacturers can put new products in-store in only a few weeks. As these items sell out, they are replaced by the next hot item, creating a "buy now or lose it" impression with shoppers, who both feel a sense of urgency and are more likely to return to see the latest trend the next week. Sourcing and short lead times are the key to this lean approach, which can produce exemplary performance in sales, comparable store sales and margins.

85% of retailers reported an increase in private label sales as a percentage of total sales, as did 47% of vertically-integrated retailing companies with an average increase of 28%, rapidly outpacing other sales growth metrics.

Source of Concern

Apparel manufacturing always seeks the lowest labor cost, but state-of-the-art global sourcing strategies introduce significant complexities related to import quotas, different labor rates, transportation, lead times, and more. For example, a US-sourced fabric might be worked into clothes offshore and therefore not violate import quota restrictions.

Today, factory groups have expanded and morphed into multinational operations. Branded apparel manufacturers that primarily use intermediary sourcing agents to link up with sources around the globe, now compete with mass retailers like Walmart and Target, who staff their own sophisticated sourcing departments around the world.

A Plan for All Seasons

Not only has the branded apparel industry typically been slow to adopt new technology, it has historically been content with basically two selling seasons per year. But the days of operating with inventory turns between two and three per year are becoming a distant memory. Fall/winter, spring/summer has already evolved to a four-season cycle, with many companies pushing the sub-season schedule to its absolute limit operating within short six-week seasons.

Apparel manufacturers can find it harder to stay current with—much less out in front of—fast-changing consumer preferences in a "new season every month" world.

Four Steps to Branded Apparel Success

Independently, each of the trends listed above has placed pressure on branded manufacturers; combined, these trends have reshaped the industry. Many brand owners have found themselves faced with changing the way they do business in order to maintain a competitive edge. The following four-step strategy can help brand owners prosper in a dynamic global economy.

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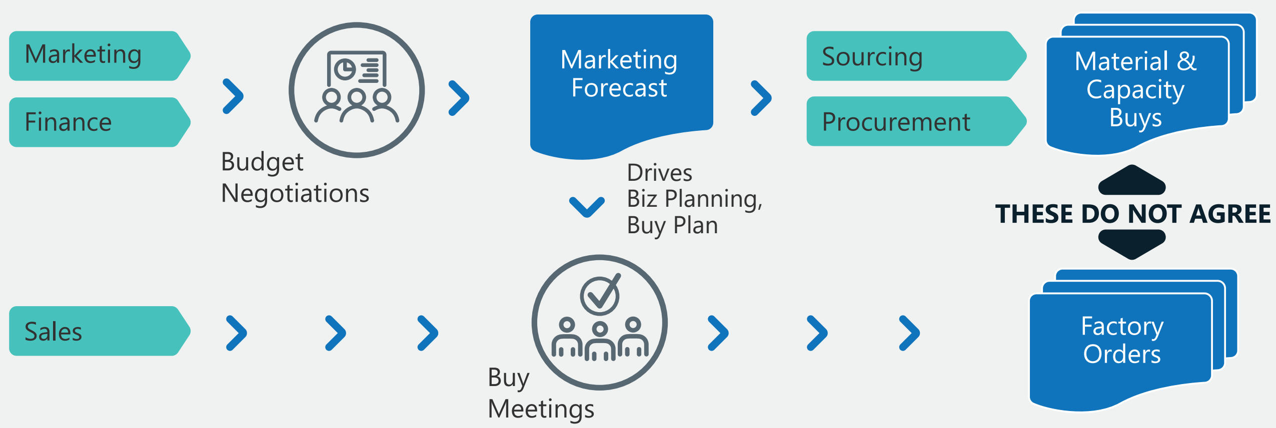
Step 1. Create a Timely and Accurate "One-Number" Plan

When the concept-to-store cycle time stretches out for months or even years, it seems only logical to generate a demand plan [or forecast] far in advance of each season. But long-range forecasts and plans typically have a high degree of inaccuracy: fashion trends, weather patterns, and regional events all change the real-world conditions, effectively "pulling the rug out from under" the plan.

Compounding the demand plan accuracy problem, organizations with a fragmented structure often encourage departments to create their own individual forecasts using simple spreadsheets. For example, specific account sales teams may decide to ensure service levels [and their bonuses] by increasing forecasts, even if the customer has not historically purchased in such volumes. Sales forecasts are often distrusted by the sourcing organization, which will proceed early in the planning process to reserve capacity based on its own forecast assessment. Additionally, the financial organization will frequently create its own forecast which corresponds to the long-range financial plan instead of real-world market and operational conditions.

The result is a group of disconnected forecasts created by different departments, driving different process and producing too much or too little material, capacity or labor. More importantly, this leads to a fractured supply chain that cannot react profitably to changes in supply or demand.

Example of multiple organizations developing separate forecasts



What brand owners need is a consensus-driven forecast, based on strong analytics and proven forecasting techniques, that uses both top-down and bottom-up input, along with historic sales data, past forecast accuracy, historical size curves, color trends, weather patterns, fashion trends, and other pertinent data, to create a "one-number plan." This plan drives the entire organization to make both upstream decisions and operational adjustments in the unit[s] of measure important to their role in the business [quantity, financial, etc.]. Typically, the net effect of a "one-number plan" is to improve margins through an increase in sell-in at the retail level combined with a decrease in inventory.

This integrated approach must be supported by a documented, collaborative process so that the plan is created to support the needs of all parties and is repeatable month after month, season after season, and year after year.

2 Step 2. Establish In-Season Excellence to Maximize Sell-through

In recent years, markdowns have increased across all segments of retail. For many retailers, products sold at markdown exceed 30% of all products sold. This is a direct result of the inadequate link between supply and demand for retailers and branded manufacturers. Neither party can afford the margin loss that occurs from markdowns and allowance dollars—not to mention lost sales caused by stock outs [which are rarely measured].

Many companies, however, continue to rely heavily on the art of merchandising, not the science of pricing, and Microsoft Excel continues to be the technology of choice for a wide range of apparel brands and retailers. Life cycle pricing, particularly markdown and promotions optimization, is still not a technology-driven activity in more than half of retail apparel manufacturers.[1]

The rewards are great for companies that improve in-season performance by increasing the availability of fast-moving items and reducing quantities for slow movers. Industry experts have shown time and again that reducing stock outs and markdowns leads to a significant increase in profits.

Technology acquisition by retailers can be a dramatic help. Many retail stores are equipped with advanced POS and other selling technologies, such as mobile devices, employee portals and easier access to customer buying histories. Leading branded manufacturers analyze point-of-sale [POS] data to quickly gather trend information. Analytics are used early in a selling season to identify how a product is performing against its forecast. Items that are selling better than expected get in-season replenishment from a hold-back inventory pool. For items that are selling slower than predicted, the emphasis is on quickly reducing risk through early markdowns and promotions, and reducing or eliminating additional replenishment. At the end of the season, inventory is funneled to locations that showed the strongest demand during the season. These steps free up budgets, production capacities and open-to-buy dollars for those products that are selling well. It requires a solid pre-season forecasting process, an agile in-season replenishment/logistics network, and accurate business intelligence to support fast decisions.

[1]Gartner, Inc. "Top Technology Trends in the Apparel Market," Feb 2010

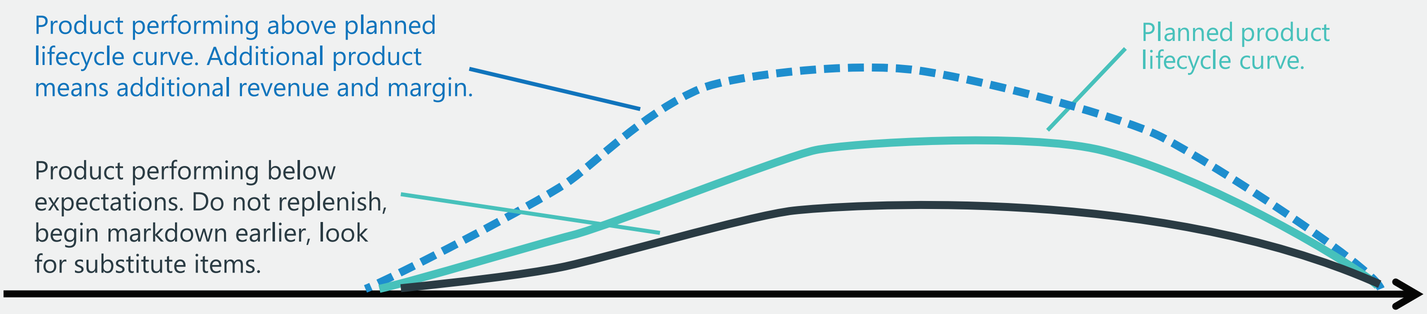
More apparel companies are “going direct” to the consumer, opening stores in the US and abroad that incorporate robust POS and customer loyalty functionality combined with lighter footprints in inventory management and back-office functions.

According to Gartner, almost half of the retailers surveyed indicated they plan to add to, enhance, or replace POS and advanced selling capabilities. If some retailers are not yet ready to share needed information in a timely manner, the branded manufacturer must lead them to this important practice. Successful manufacturers must confidently and accurately articulate and demonstrate the benefits for the retailers who provide timely POS data. Innovative companies have generated strong benefits for themselves and their customers by sharing information and implementing vendor managed inventory [VMI] and retail replenishment programs.

Branded apparel companies that do well in replenishment and VMI also have the opportunity to become the category captains in those channels that promote Category Management.

An optimal sourcing decision takes into account inventory risk, customer service goals, demand variability at the SKU level, and supply chain responsiveness.

Decision-making criteria in-season using POS data, data warehouses, and analytic tools



Preseason
- Forecast initial demand
  - Prior similar prods
  - Survey groups
  - Art of merchandising

Early Season
- ID demand trend vs forecast
- Expedite or cancel orders
- ID pricing strategy to max

Mid Season
- Add’l shipments of fast-moving items
- Begin markdowns
- Manage products based

Late Season
- Manage end of life
- Add’l markdowns
- Transfer products to outher stores, outlets

Step 3. Develop a Synchronized Supply Chain

A reliable "one-number plan" sets a strong foundation for demand-driven supply chain performance. Whether a branded manufacturer has its own cut, sew and distribution facilities; contracts for full packaged goods; or uses a hybrid approach; the goal is to maximize sell-through and margin.

Apparel companies are segmenting their target customers and localizing assortments to best serve a local shopping audience. Segmentation is placing more emphasis on the supply chain as apparel companies look for the most intelligent way to design, source, manufacture, and deliver increasing varieties of product to more and more customer types. Given the proliferation of stock keeping units [SKUs], customer segments, as well as sourcing, manufacturing, packaging, and shipping combinations, a "one-number plan" is easier said than done. Companies struggling to efficiently manage their supply chains need to go beyond spreadsheets, and acquire scalable software solutions that are rich in optimization capabilities.

As with all "game changing" improvements, it is important to obtain executive-level recognition of the threat or opportunity, and secure the commitment and involvement of senior management to address the issues at hand.

Planning

Effective pre-season supply planning translates the top-down financial plan, business goals and forecasts into product offerings, price points, and assortment plans for the retail door level. The other side of the coin is a bottom-up plan based on pre-season demand signals. This plan includes inventory optimization initiatives, such as postponement strategies, that create flexibility during in-season demand shifts.

Sourcing

Fundamental sourcing decisions must be based on maximizing full-priced sales while minimizing inventory risk. There are tradeoffs between longer lead-time/lower cost off-shore manufacturing vs. shorter lead-time/higher cost domestic and near-shore manufacturing.

Without adequate analysis, planning to capture 100% of demand may drive excessive inventory investments and result in negative margins. Optimization is based on total landed cost, not just manufacturing cost. In-season replenishment may only be possible through the higher-cost local supplier, but this is often acceptable when it produces higher margin sales, reduced risk and increased market share.

Replenishment

Assortment plans become in-season allocation plans that place product in stores. Today's competitive advantage comes from excellent in-season replenishment, based on a solid combination of timely POS feedback that signals where product is actually selling, and flexible inventory holding policies that put finished goods close to the consumer, but include hold-back pools that provide flexible response to real buying patterns as they emerge.

Logistics

In-season adjustments also require changes to logistics' business-as-usual. While apparel industry excellence still depends more on the planning phase, branded manufacturers are experiencing a new emphasis on execution, driven by "fast read" situations in which retailers funnel product to specific stores within a limited time window. Execution must "plan for surprises," and be ready to implement account trans-shipments, re-routing and other tactics that minimize costly expediting.

This flexible supply infrastructure minimizes exposure to end-of-season discounting by executing a feedback-driven final push that positions product for maximum sales and fewer markdowns.

Performance management tools let planners and expediters define their workflow norms, and then issue alerts based on exceptions.

Performance

Finally, apparel excellence requires performance management, or "management by exception." Performance management tools let planners and expediters define their workflow norms, and then issue alerts based on exceptions. Users can focus on the exceptions quickly and deal with them according to priority—a huge increase in efficiency and time management.

With a "one-number plan" at its foundation, the supply chain's synchronized sourcing, production, logistics, inventory optimization, and replenishment activities create a responsive organization that minimizes excess inventory and excessively large lot sizes, achieves customer service targets and mitigates production risk.

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Step 4. Integrate the Three Steps into a Holistic Business Planning Process

In steps 1—3, brand owners create a fundamentally sound "one-number plan" that is used by all departments, develop the mechanisms to better understand sales trends and changes at the retail store level, and develop a synchronized supply chain to enable greater flexibility. The final step is bringing these capabilities together to drive a competitive advantage, enable in-season excellence and improve sell-in and sell-through, while reducing inventory and supply chain costs.

Executive Level Recognition

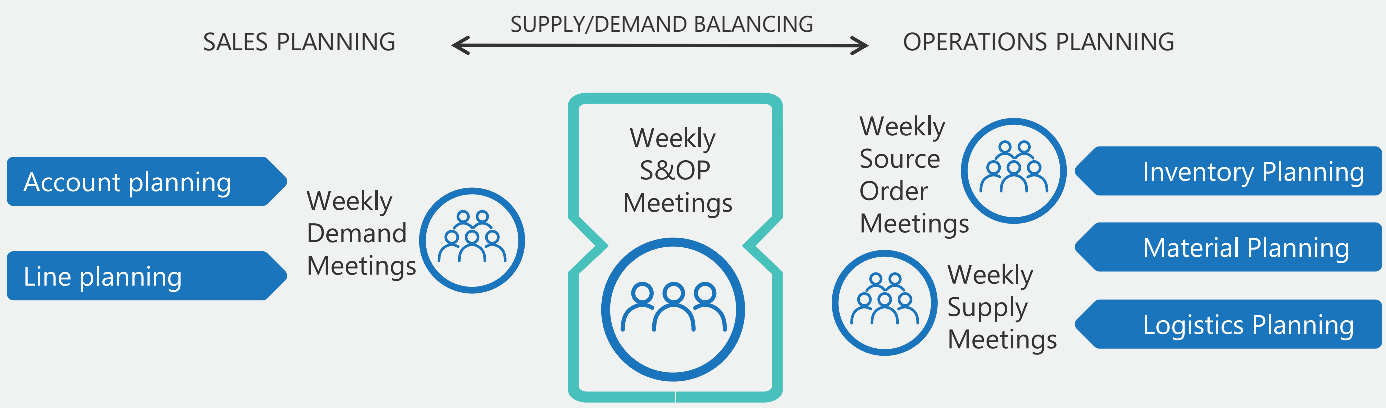
As with all "game changing" improvements, it is important to obtain executive-level recognition of the threat or opportunity, and secure the commitment and involvement of senior management to address the issues at hand.

Integrated performance metrics are necessary to ensure desired behavior throughout the organization. When you define how someone is measured, you have determined how they will act. The reality for many companies is that their key leaders are not measured and rewarded for the correct behavior.

In some cases, sales managers are measured and rewarded for reaching sales and service level goals, without regard to margins, allowances, gross margin return on investment [GMROI], or other holistic measures that truly reflect corporate success.

To manage the integration of these core competencies, branded manufacturers need a robust and consistent sales and operations planning [S&OP] process. An interactive S&OP process is vital for resolving issues that may impact the plan. Two elements are needed: a weekly tactical component to address short-term supply and demand mismatches [within the next month], and a strategic component to monitor issues that impact the long-range financial plan. In a robust S&OP process, sales, marketing, planning, sourcing, development, and finance interact weekly to resolve critical issues. Senior management uses the same planning process model for strategic plans and to address future challenges and corporate objectives that impact the overall business.

Weekly sales and operations planning process example



Conclusion

Leading branded apparel companies have begun to redraw the blueprint for success. Leading-edge supply chain capabilities combined with a holistic business process dramatically reduce cycle times, increase visibility across the entire value chain, enable quick response to changes at retail, and ultimately deliver increased customer satisfaction. The company delivers the right product at the right place and time, at the right price, and in the right size and color.

Overall industry success and survival depends on each brand owner’s ability to radically change how business is done. The four steps that can move you in the right direction are:

- Create a timely and accurate “one-number” plan
- Establish in-season excellence to maximize sell-through
- Develop a synchronized supply chain
- Integrate the three previous steps into your S&OP process

Companies that have done this successfully have typically innovated across “people, process and technology,” while upgrading to advanced software solutions to support them.

About Logility

Accelerating the sustainable digital supply chain, Logility helps companies seize new opportunities, sense and respond to changing market dynamics and more profitably manage their complex global businesses. The Logility® Digital Supply Chain Platform leverages an innovative blend of artificial intelligence [AI] and advanced analytics to automate planning, accelerate cycle times, increase precision, improve operating performance, break down business silos and deliver greater visibility. Logility is a wholly owned subsidiary of American Software, Inc. [NASDAQ: AMSWA].

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