AN Apparel THOUGHT-LEADERSHIP REPORT

Marrying Your **Physical** and **Financial Supply Chains** To Create End-to-End Benefits

By working closely with suppliers and finance partners on innovative financing methods, and utilizing new web technologies to connect the physical and financial supply chains, apparel companies can keep costs at bay and continue to do what they do best: make the garments that consumers love.

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Rising costs — of everything from raw materials to labor to transportation — are currently wreaking havoc on the apparel industry's physical and financial supply chains. While operating costs have always been a drain on the bottom line, the rapid increase in prices of commodities such as cotton and polyester, as well as rising oil costs and transportation expenses, combined with an uptick in foreign labor rates, have apparel companies stuck between the proverbial rock and a hard place.

Cotton prices, which are up some 170 percent since early 2010, recently soared to the $2-a-pound mark for the first time ever, while oil prices have risen as much as 30 percent during the past three months. As a result, transportation costs have risen significantly, which is distressing to the apparel industry's global supply chain.

In addition, as sourcing in countries such as China and India has matured, labor rates have increased, driving apparel manufacturers to seek out new sources of inexpensive labor.

"These changes in labor rates are going to be long-term," says Bill McBeath, chief research officer for ChainLink Research. "As countries like China and India lift themselves out of poverty, their labor costs are going to rise faster than the average rates elsewhere, which puts upward pressure on prices."

To make matters more challenging, this scenario is playing out while the global economy is still healing from the recession, and consumer spending remains tepid. Shoppers are still being cautious about how they spend, and aren't willing to take on the higher prices that apparel companies would like to charge to make up for their own rising costs. The result? Apparel brands, retailers and manufacturers are being squeezed on both sides, making it harder and harder to thrive.

Controlling What You Can

But, while they cannot control the macroeconomic forces that have landed them in this position, the good news is that many apparel companies are developing smart ways to find efficiencies in what they can control. This means taking steps to reduce supply chain and operations costs related to overhead, processing and capital.

It may also mean forgoing risk and embracing more conservative financial strategies.

"At a time like this, with rising commodity prices and higher costs, you want to lock in the cost components that are controllable. Whereas you may be willing to take financial risks if other costs aren't rising, when you know the base cost of materials is rising, it reduces your risk appetite for the other pieces of the cost equation," explains John Bailey, director of finance for outdoor apparel brand Columbia Sportswear.

One important step toward controlling what you can is casting a focus beyond the physical supply chain and realizing the impact of the financial supply chain.

"The importance of the financial supply chain can't be underestimated; it is the enabler of the physical supply chain," McBeath explains. The two are inherently intertwined for apparel brands: garments cannot be designed, produced and distributed without the proper funding, and supply chain strategy, practices and execution all have a tremendous impact on cash-to-cash cycle time and working capital, he notes. As such, taking steps to improve the efficiency of your financial supply chain has important benefits for the entire end-to-end value chain.

Helping Suppliers Helps Brands

But where to begin? For many apparel brands, working more closely with suppliers can be an unexpected way to boost financial supply chain efficiency. Connecting your supplier network to better communicate and collaborate on financial issues, as well as making financial services available are strategies that are gaining favor.

"One thing that comes into play for the apparel industry is the fact that a supplier's cost of credit is often much higher than an apparel brand's or OEM's cost. If those suppliers are not able to leverage the brand owner's credit, then when they borrow money they pay more, and that has to get passed on as part of the cost of goods," McBeath notes.

Because so many of today's apparel brands buy on what is known as "full package"—where the brand designs the garments, but outsources all production to contract manufacturers — manufacturers must purchase the raw materials and components necessary to deliver the brand's finished goods.

"That means manufacturers and suppliers must have access to capital at the right time to purchase whatever materials they need to produce finished goods and deliver on time to meet the expectations of the brand," explains Justin Goheen, director of business development for RTS Financial, a commercial finance company that provides capital for many apparel industry firms.

"Often these contract manufacturers have balance sheets that look much different from the global brands they are working for, and they are located in emerging markets with far less access to capital," he adds. "They are saddled with working capital constraints in trying to produce these products."

One option for apparel brands is to have their suppliers connect with a finance company such as RTS via an online trade finance and supply chain collaboration platform. These web platforms connect buyers, suppliers and service providers, allowing them to automate and optimize transactions online, which can lead to improved margins and cash flow throughout the transaction cycle.

"These platforms can either help the buyer directly take advantage of innovative payment programs, or allow an intermediary, such as a bank or financing company, to assist them," explains McBeath. "These platforms make it easy to provide and access the information that helps lenders get visibility, reducing their risk and reducing the cost of lending."

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EXECUTIVE INSIGHT

An Interview with Bob Copeland, Senior Vice President, Product Strategy & Business Development, TradeCard Inc.

What is the biggest financial challenge apparel brands face today?
BOB COPELAND: Apparel companies are facing considerable pressure on costs. The prices of raw commodities that go into finished goods — like cotton and polyester — are rising, and that, in turn, means rising costs for yarn or fabrics. Also labor costs are rising steadily, particularly in China.

What are the implications of these rising costs?
COPELAND: In many cases, apparel companies are being forced to look elsewhere for cheaper production. That means going from a very reliable and predictable sourcing base in China to countries like Bangladesh, Sri Lanka and Vietnam which have cheaper labor rates, but lack that history and dependability you find in China. It can also be more challenging to conduct business in these countries.

Apparel companies are also seeking ways to decrease the cost of producing their garments, by either using less expensive, lower-quality raw materials, or engineering the finished goods to incur lower costs based on things like stitching and construction elements. Smart companies are leveraging their suppliers to figure out how they can produce cheaper garments without impacting how the merchandise looks and how it performs.

How else are apparel brands working to control their costs?
COPELAND: Another strategy is to seek efficiencies in transportation and labor costs by reducing the number of touches between the factory and the store. What we are seeing, particularly for initial seasonal deliveries, is that more of the packing is being pushed back to the factories — they will package goods in a mix of sizes so when they hit an apparel brand's distribution center, workers only have to determine which store the goods are bound for. Boxes can be set up to represent either a specific stores' demand for that product, or a representative demand. More and more companies are asking their factories to do this so the goods either bypass the apparel brand's DC and go right to the store shelf, or if they do hit the DC, require fewer steps to be ready for shipment to stores. This strategy can help apparel brands cut back on both labor and transport costs.

What about apparel suppliers and vendors — what fiscal challenges are they struggling with?
COPELAND: Capital constraints are the main concern for apparel suppliers. Factories, vendors and raw material providers need to have access to capital at the right time so they can purchase the materials they need to produce finished goods for their apparel brand customers. You don't want suppliers financing their goods in a way that ends up adding to the cost of finished goods. Take an apparel brand working with a factory in Bangladesh, for example. If that factory doesn't have the cash to buy raw materials and has to borrow money locally, it may pay up to 10 percent or 12 percent interest, and that cost will be passed up to the brand as part of the finished goods cost. Ultimately, that added cost ends up as a hit on margin for the brand, or is passed on to the end consumer.

So how can apparel brands work with their suppliers on these issues?
COPELAND: The key is allowing suppliers access to cheaper capital at the right time. One smart option for apparel brands is to offer an early payment program, where they pay their vendors earlier in the process, but at a discounted rate. It gives suppliers earlier access to the cash they need to purchase raw materials, while allowing the apparel brand to pay a lower rate for its goods. Early payment programs can either be financed through third-party banks or financial companies, or directly from an apparel brand that has the necessary cash on their books.

On a more macro level, apparel brands can also work with their vendors and raw material providers on long-term planning. So with raw materials, for example, an apparel brand can look at where it may use the same or similar fabric across different parts of its business, and then consolidate its spend and negotiate better pricing with the raw material provider. This gives the supplier a chance for higher volume and predictability and gives the apparel brand a chance to control costs.

Are these simply short-term strategies or do they have staying power?
COPELAND: Companies are looking right now to find better ways of operating because they are squeezed on cost, but these are smart business strategies overall. We expect to continue seeing apparel brands and suppliers working to better integrate their financial supply chains with their physical supply chains.

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Putting Cash in the Cycle

As a company that focuses on financing transactions, RTS has found this online trading platform ideal. "Our role is to interject financing or working capital into the overall transaction lifecycle. Through the online platform method, we can do that at various points along the transaction cycle," Goheen notes.

RTS interjects that capital at two critical times in the transaction lifecycle. Its main focus is providing advance funding to apparel manufacturers for their receivables. Once the manufacturing process has been completed and the product is ready for shipment, RTS will fund against the receivable that is ultimately created between the seller and buyer. The company also funds manufacturers at the time when a purchase order (PO) is first issued, so that the vendor has the capital it needs to acquire raw materials. Because RTS is connected to its apparel manufacturing clients via the online platform, it can easily view when these transactions are taking place, providing it with a trigger to release funding.

"We receive automatic notification that a PO has been issued and approved across the platform, and, at that time, we can advance a certain percentage of funds to the client. Then, when they are ready to ship product, the manufacturer uploads its invoice onto the platform and we can receive automatic notification that the invoice has been approved so we can fund at that time," Goheen explains.

One of the main advantages of providing this financing via an online platform is the efficiency and time savings it provides for RTS, which ultimately creates efficiencies for its contract manufacturer clients and the apparel brand.

"All the documents we'd traditionally collect from the various parties along that transaction cycle are deposited into a single place and managed electronically. Having access to that data real-time makes our due diligence and the steps associated with the financing process very easy for us and our clients," Goheen says. "Also, the ability to track transactions from start to finish as well as have visibility on the historical performance of the parties in terms of their ability to perform on their contractual obligations is extremely helpful for us."

Innovative Financial Thinking

In some cases, apparel brands will choose to work directly with their suppliers on innovative financing options that help to cut down on costs and streamline the financial supply chain. Columbia Sportswear, for example, uses its own funds to offer its suppliers an early financing option that is a win-win for both the brand and its vendors.

Using an online trading platform, Columbia offers its vendors the option to be paid for their goods upon shipment at a discounted rate, which gives the vendors earlier access to capital and allows Columbia to pay a lower rate for its merchandise.

"Once all the documents have been approved, and we have a receipt of the goods at our consolidator, we'll issue payment. We apply a discounted rate based on how early we are paying them, reducing the amount we owe," explains Columbia's John Bailey. "So we have possession of the goods, we've utilized our cash to provide our vendors with better liquidity, and at the same time, we haven't changed the risk profile of the transaction."

Using its cash in this manner provides Columbia with a better return than it could get investing anywhere else, Bailey says.

Though he is not willing to share how much Columbia has saved by utilizing this early payment option, Bailey calls it "significant." And, by taking a bank out of the equation, Columbia helps the company's manufacturers keep their costs low, which in turn, keeps those costs out of Columbia's supply chain. "It's beneficial for both of us. We are charging a lot less than a bank would charge and for us it's a greater return than we would earn in alternative investments," Bailey says.

Columbia has also tweaked its financial supply chain to improve efficiencies and keep costs in check through customs and duty optimization. Because it imports its garments, Columbia has to provide customs invoices for its goods coming from overseas. Historically those invoices were often different from the financial invoices it uses to pay for the goods, which resulted in time and effort spent reconciling the two invoices. Today, it uses one document that guarantees that the customs portion and the financial payment portion will match, cutting out the reconciliation time and effort, and allowing the company to optimize aspects of the duty classification process.

Columbia facilitates these processes through an online trading platform, which makes execution, tracking, and reporting quick and efficient. "We've been able to reduce man hours dedicated to the payment process and in our customs group," Bailey notes. "We've automated processes that were previously manual, and we can now run reports and share that data with our other service partners. We've also gained visibility and transparency; everyone is looking at the same source data through the same platform."

Ultimately, however apparel companies choose to tweak their financial supply chains and processes, they must do so with an eye toward controlling what they can in the wake of macroeconomic forces that have sent costs spiraling ever upward. By working closely with suppliers and finance partners on innovative financing methods, and utilizing new web technologies to connect the physical and financial supply chains, apparel companies can keep costs at bay and continue to do what they do best: make the garments that consumers love. ■

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