

Breaking the "Chain"



Apparel and footwear brands and retailers have for years faced a challenging proposition: To meet Wall Street's mandate for growth amid a deflationary market for their goods. Their basic response is no secret — in addition to pursuing acquisitions, they are moving to a supply ecosystem model.

In a supply ecosystem, parties work together as a unit to deliver a shared outcome. Production is closely tied to demand, inefficiencies are stripped from sourcing processes, and gross margin and even revenue eventually are improved. In contrast, members of a supply chain focus on linearly contributing their individual piece to the process, functioning nearly independently of one another.

Because of the ecosystem model,

How using supply ecosystems can deliver near-immediate gross margin benefits.

By Marshall Gordon

more and more brands and retailers compete based on their ability to manage the entire order process. These buyers rely heavily on their suppliers and work hard to synchronize their operations.

However, a quickly attainable — and often overlooked — step towards the ecosystem model is collaborative

finance. Consider that most buyers know exactly how much a key supplier pays for fabric, but are unsure of that same supplier's cost to finance the purchase of the fabric. Yet, for both parties, the impact on cost of goods and, in turn, gross margin can be significant. Collaborative finance has the added benefit of providing both buyers and suppliers with tools to better control cash flow and transaction processes.

One-Sided Finance Models Prevent Margin Improvements

Buyers sometimes push margin, cash flow and operational improvements on the backs of their suppliers. For instance, buyers might free cash for acquisitions via an extension of payment terms. Likewise, improvements

to gross margin might be found by concentrating orders among fewer suppliers and exerting greater leverage in price negotiations. Collaboration is, in these scenarios, nothing more than suppliers complying with buyer-mandated policies and pressures.

As many brand and retail executives are coming to realize, this one-sided approach is not optimal. A better approach is to enable both sides of the transaction to generate mutual improvements to cash flow performance, cost of goods sold and operational efficiencies.

Many top apparel and footwear companies are employing this approach today. It is made possible by increased collaboration between trading partners, as well as converging physical and financial supply chains and their evolving enabling technologies.

Collaborative Finance Achieves Lowest Possible Transaction Cost

There are two basic principles behind collaborative finance:

- Firms most dependent on capital are also paying the most for it.
- The overhead driven by managing credit risk across partners is significant, whether through processing archaic letters of credit with endless fees and delays, or through trading partners charging each other a premium to offset risk.

The traditional finance model dictates the combined financial strength of the partners is always based on the weakest partner, unless costly guarantees and prepayments are facilitated. Collaborative finance flips this dynamic on its head, injecting the credit and capital of the strongest partner — typically the buyer — down into the supply chain. Suppliers, in turn, gain access to credit lines determined by the buyer's credit worthiness. Technology enables this transfer to occur without requiring

the buyer to make guarantees or take on administrative burden.

By offering "cost of capital optimization" to trading partners, the stronger partner reduces its cost of goods. After all, any cost on the supplier's balance sheet — whether it be for fabric or capital — is marked up and passed back to the buyer. In international transactions, duty costs sometimes magnify this markup, further impacting cost of goods.

Existing Frameworks Drive Results In 60 Days

Collaborative finance hinges on real-time collaboration and automation between trading partners, as well as the integration of any necessary financial service providers and logistics partners

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into the process. Otherwise, the administrative burden can erase the benefits, or make them impossible.

The good news is that trading partners can realize this approach in the near term, often within 60 days. The key is to leverage an existing financial, legal, logistics and technology framework.

Consider the case of Burton Snowboards. It uses a third-party platform to automate the exchange of order and invoice information, as well as to provide suppliers with access to financial services such as payment guarantees, export financing and discounted early payment. The services are based on Burton's stronger credit rating and cash reserves, but do not require the company to make payment assurances or perform additional processes.

The result for suppliers is an automated, cost-effective way to finance Burton's growth. "Our business with Burton increased by 56 percent this

past year," said the president of one of Burton's largest suppliers. "Supporting this growth on 30-day terms stretched our cash thin. We had to hire 60 more people and start purchasing far more raw materials. Now that we can opt for five-day payment terms, we have the cash we need to support Burton and grow our business."

Meanwhile, according to Burton's treasurer, "We're surpassing the return we saw from extending payment terms."

Some companies take this concept a step further, expanding the ecosystem both up and down the traditional supply chain. For instance, Hong-Kong based TAL Apparel, one of the world's leading garment manufacturers, uses the same third-party platform for its

retail customers and its suppliers so that each member of the ecosystem — including TAL Apparel itself — has access to the most efficient financing mechanisms. This more expansive take on collaboration has eliminated 30 to 40 days from TAL Apparel's order-to-cash cycle, according to GartnerG2, a provider of research and analysis about the global information technology industry. TAL Apparel also forecasts working-capital savings of \$20 million by using the approach.

In short, collaborative finance helps trading partners achieve mutual gain, rather than pushing costs from one side to the other, where they eventually return in the form of higher prices. AAPN

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