

DECIPHERING OF THE GLOBAL FASHION BUSINESS

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The coronavirus pandemic's impact on the fashion industry is going to be huge. You can compare its impact to a devastating 10 on the Richter scale—something we've never seen before.

It all started when shoppers were forced to stay home. All of a sudden all demand for fashion stopped. We were only allowed to go out to shop for the daily essentials, and the biggest disruption came to our clothing. The whole supply chain experienced enormous gridlock; I'm not exaggerating to describe the whole thing as a tsunami.

Retailers were told not to make any further shipments so all finished goods were cancelled, work-in-progress was suspended, all materials for the orders were denied, all written orders were invalid, and all payments were frozen.

From one day to the next, the factories in the developing countries found they were left without an order book. Since everything was cancelled, payments to accounts receivable were not coming, factories were still occupied by the whole labor force, and no discussions could make sense to solve this matter.

Progress was stymied until the labor representatives and the human rights organizations that intervened with the retailers, along with a few of the larger retailers, started to soften up and come to some conclusions in taking on certain liabilities, although it couldn't be 100%.

Some governments from certain countries were offering relief funds, even if it was a fraction, yet such actions were able to solve only part of the problem.

On the other hand, the retailers started to furlough their staff and their government stepped in to provide some financial relief during the time when the shops were closed. Most of the retailers stopped paying their rent, which started another problem for building owners who failed to pay their mortgages.

You can find some retailers who are able to operate part of their business online, but such business revenue generated via online sales was a drop in the bucket. Their distribution centers still needed their staff to do pick-and-pack fulfillment of orders; with the disruptions in postal service, most of the deliveries depended on courier services, which were more costly and quickly became congested until they could clear their loading.

The majority of the people were told to work from home; children also needed to adjust to school-from-home learning. But the less lucky ones were fired from their jobs, especially those working in the hospitality industry including restaurants. All of a sudden, joblessness skyrocketed; conservative estimates projected 20% of workers would be out of job or not fully employed.

These developments have tightened up spending because people are concerned about their income; if a particular item is not absolutely necessary, they would hold back on their spending.

It wasn't until July 2020 when the shops started to open and the situation started to improve slightly.

McKinsey & Company, a global management consulting firm, estimated that up to a third of the global fashion players will be wiped out by this pandemic. The \$2.5 trillion fashion industry has been going through a shockwave throughout its very sophisticated supply chain—from the department stores and brands—and began to crumble like dominos. Not everyone can have access to government-funded emergency support. We have already seen factories that closed, shops and department stores that have shut their doors, and finished goods from the past seasons stockpiled without any destination to realize their residual value. We are looking at the tragedy already taking place.

No one is talking about placing orders for the Spring season, although at this time of the year the shipments for Fall/Winter and the Holiday should be issued according to the seasonal schedule. We know that business generated between September and the end of the year normally represents 35% to 40% of the yearly turnover. This year, even if the department stores can reopen, they will find their prospects dismal.

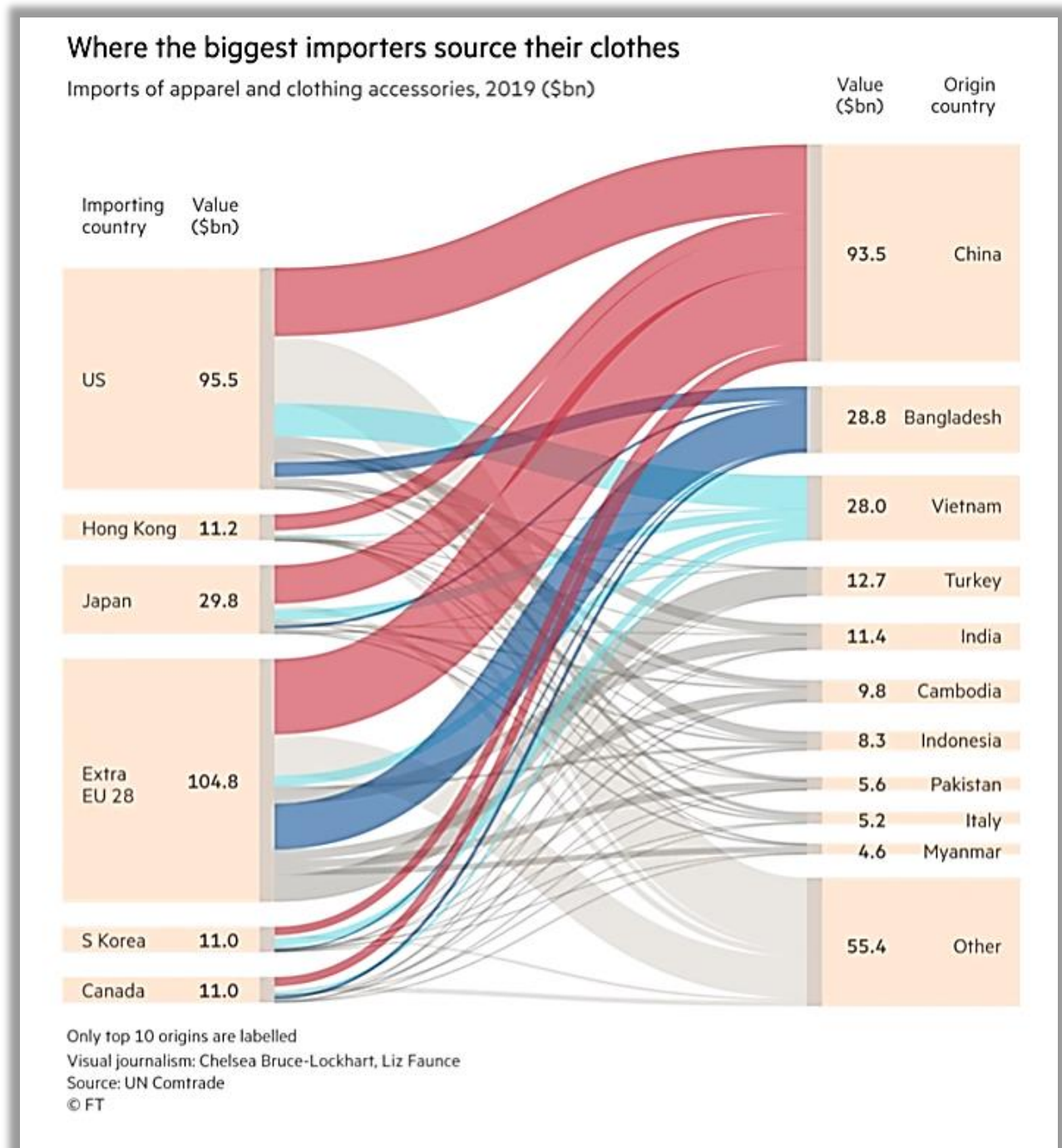
The sentiment of the manufacturers is a mixture of anger and frustration caused by the helpless situation, and many of them are afraid to take their claims to the higher level, such as filing litigation to collect for damages in case of non-performance of the purchase contracts from the buyers. Most of them dare not challenge the buyers because they are afraid of any revenge tactics as well as having their companies black-listed for taking legal action.

We have watched the buyers move toward doing business with the cheapest sourcing countries for the lowest cost. They used to call you their partners, convinced the manufacturers would find the next country with the lowest cost for production to pass the cost benefit analysis results on to them. When this pandemic came, they were busy trying to save themselves so disregarded their so-called business partners. But eventually, some of them would pay something to their suppliers, which would probably be the minimum. Otherwise, they would have killed their loyal suppliers, which they would need when the market returns one day.

The use of a retrospective discount has become a common business practice. Buyers are using this tool as part of their partnerships with suppliers. This means a quantity discount applies when they hit a certain volume of business with you; in other words, the more business they send to you, the bigger the discount they get.

Those who have already filed for bankruptcy protection or undertaken a reorganization want to start everything anew with their new capital. They would need to pay for anything going forward but what was already delivered or what they owe you would be wiped out. So the suppliers would need to turn the page, so to speak.

You can refer to the apparel business for both imports and exports. The exporting countries are those where the products are coming from. This chart was drawn up in 2019 before the pandemic so its use is limited now because everything needs to be rewritten. I presume that fast fashion will not be entirely diminished but it will be changed in a different way. They have to find how the market will behave as the volume in business will not be feasible as the market changes toward another equilibrium. It will undertake some changes and tweaks along its way before it can be established once again. Such projections for the volume of imports will take a few seasons to become definite.



But we have to be aware that in 2019, 97% of the profits in the fashion industry were generated by only 20 companies, including Inditex as the company representing fast fashion and Nike for sports shoes and sportswear.

It is extremely difficult for garment manufacturers to become successful in this business as the buyers are controlling the complete supply chain, They start with fabrics and trims for their factories, where they developed the design and the quality, and then they negotiate the best price for their benefit. When they are placing their orders, they can allocate them in different countries with different vendors and play everything as a strategy in their favor. The vendors are only told to perform according to their order allocation.

Even in terms of product development, everything is passive for the manufacturers. You will only be told how to react. More sophisticated customers can even do the order allocation about the details of loading the sewing lines. They have asked for their designated production lines. Because you are the partner, you will have to open your book to show them. They know exactly their business penetration in your company; they know if you can deliver for them and what kind of skills and quality you can deliver. They can even dictate your profitability, which they will use in price negotiations.

In the end you essentially manage a group of workers with different production skills—be it the sewers, cutters, finishers, or packagers. You will buy all the necessary fabrics and trims for the business in according to the production requirements. You will provide the working capital and wait for your bills to be paid, which can range from 60 days—for good customers—or 120 days—for normal customers. All in all, you are looking to finance your business for 270 days, or nine months, before you can receive your payments. This expectation is a matter of being prudent, and you can count on it. Actually, you are holding the “money bag” for your customers.

You can count yourself lucky if you can have 10% as your gross margin. I think this number is down to a single-digit percentage already and will continue for quite some time. Total material costs can be as high as 70% already.

It is already known that fabric mills and accessories vendors are demanding early payments from the manufacturers. They have always been skeptical with the garment manufacturers and worried about their accounts receivable, which is quite true as the margin has been razor-thin for a very long time, so to speak.

The industry has been going through a total consolidation so to make money is extremely difficult. The problem is that it is already in the hands of the “veterans” from the manufacturers who switched camps; the customers have been using them to deal with the manufacturers across the negotiation table. I would think that anyone who has the right mindset and survives the pandemic won't enter into the rag trade again.

This pandemic is like a sword piecing the heart of the garment vendors.

Once the business was dominated by China. Manufacturing has been moving out of China, because of the rising cost of their labor, and has been taken over by Bangladesh, Cambodia, Myanmar, Vietnam, and India.

As you may know, in Vietnam, which has the fastest-growing economy in Southeast Asia before the pandemic, the garment industry is its second-largest industry after the assembling of semiconductors. As noted, if the lockdown lasts until June 2020, the countries' textiles and garment factories could lose as much as \$500 million in revenue. About 400,000 to 600,000 workers have lost their jobs out of a pool of 2.8 million workers in this sector.

Bangladesh is the world's second-largest garment manufacturer behind China and hired 4.1 million workers. Right after the lockdown, 70% of the factory workers from Dhaka were sent home, most of them without pay. The last we read is that half of the factories have resumed work.