

## LEAN AND MEAN

### Operating on Leaner Inventories to Free Up Credit and Avoid Costly Overstock

It is no secret that lines of credit available to apparel companies have become scarcer and the financing that is available carries more onerous terms. This challenging credit market has left apparel companies with limited flexibility and, at times, facing unpleasant or expensive alternatives. As they look toward another quarter of restricted credit markets, it's vital for apparel companies to make the most of their available credit.

To do so, many manufacturers have begun to consider unconventional strategies and short-term sacrifices in the name of long-term profitability and viability. By embracing a lower sales volume and striving for a quicker turnaround on production, apparel companies can make the most of the credit they do have and avoid serious losses from overstocked positions.

#### Sell Out

Out of classic optimism or lack of quantifiable guidelines, apparel companies generally err on the side of over-ordering. When excess inventory remains unsold, all of the credit invested in it stays tied up and unusable. In the long run, excess inventory can also cost companies money and brand prestige if they are forced to sell overstock at a loss via atypical distribution channels such as deep-discount retailers.

Apparel companies can aim to reduce or eliminate overstock and free up lines of credit by adopting a lean inventory strategy, targeting a sold-out position, and manufacturing less product.

To adopt such a strategy, a company should start by restricting its manufacturing

### FACTORS TO CONSIDER

The financial climate has changed dramatically for everyone—including factoring companies. The terms of most factoring contracts have been written with the underlying premise that the borrower may run into financial trouble or become insolvent. However, it is no secret that the factors themselves are facing financial difficulties. Apparel companies absolutely must look into their contracts to ensure they're minimizing their own risk in this environment.

The good news is that factors should be willing to work with apparel companies in restructuring these agreements and making sure all parties are satisfied with the terms. Most apparel companies simply renew their factoring contracts each year, but in the current economic climate, apparel companies shouldn't hesitate to renegotiate those contracts. Apparel companies should draw on their accounting and legal professionals to develop a list of modifications that will help protect their businesses.

If a company's yearly contract will soon be up for renewal, starting the renegotiation process should be easy. Most contracts automatically renew after a certain date, so it's important to give notice that a modification is desired before the deadline. If the deadline has already passed, or if it is months in the future, companies can still act now since many factors are willing to discuss contract modifications in order to retain their existing clients.

orders below expected sales. For example, if a company believes Fall sales will be 80 percent of the prior year, they should consider going one step further by cutting orders to 75 percent of the prior year. Accounting and consulting professionals can help companies analyze the market more deeply in projecting their likely sales targets. Where appropriate, they can also put systems in place to make sure stock and related costs are controlled and documented. Selling out inventory may mean incurring an implicit marginal loss in terms of a lost opportunity to sell more, but most customers are unlikely

to punish apparel companies for running out of stock in this environment.

Another important consideration is one that apparel industry decision-makers often overlook: Make sure the right person is in charge of purchasing. Having salespeople do the ordering enables them to over-order commissionable products. Orders should be placed by a decision-maker who has no conflict of interest, a realistic and nuanced understanding of the present market, and a handle on and interest in the costly consequences of overstocking.

If an apparel company is left with overstock, every effort should be made to handle its sale and distribution with grace.

Relationships with higher-end retailers could suffer if they discover that the same items are being sold to deep discounters for a dramatically lower price or via an outlet that may be lowering the inherent value of the brand. Apparel companies can't afford to squander dearly won brand prestige by letting consumers find their products hanging between the dog food and the tube socks at a big-box discounter.

### Get Local

Typically, apparel companies send their work overseas to take advantage of the substantially greater profit margins although shipping product from China requires long lead times. During that time, a company's credit is committed to the manufactured goods en route and is completely tied up. Shipping by air freight allows for a much quicker turnaround time, but the expense can be so high as to negate most of the marginal gains from manufacturing overseas to begin with.

Instead, apparel companies should consider manufacturing locally or regionally in the United States, Latin America, or the Caribbean. This may reduce profit margins, but it will cut turnaround times drastically, for example, from eight weeks to two. Accepting slimmer profit margins allows them to free up scarce and valuable lines of credit.

Moving manufacturing to these regions may not be right for the entire business, but may be an ideal solution for certain product lines as companies continue to navigate their way through a struggling economic environment. Consultants with expertise in the apparel industry can help analyze the options that are right for companies and identify the most prudent ways to maximize their available lines of credit.

### Adjust Expectations

With retail sales slow and expected to stay slow through the next two quarters, retailers will continue to limit their orders over the coming business cycle. Apparel companies will have to adapt to the situation

and change the fundamental way they approach business if they want to stay competitive. Reducing or eliminating overstock and improving turnaround time may require unorthodox strategies and some short-term sacrifices, but will allow for more effective use of capital and position companies to take advantage of new opportunities as they emerge. ■

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