
Outsourcing, Near-sourcing, and Supply Chain Flexibility in the Apparel Industry (A)

“There is probably something to it...,” Timm Veizenburg mumbled quietly, as the team of consultants continued their markdown strategy report.

“Put the markdowns aside; we have to rethink procurement!” he said much more firmly, just a minute later.

“Jason, could you pull the data for the LECs thus far, and remind me again, how many are we ordering?”¹ It just occurred to me that the markdown issue we are dealing with may not be a pricing problem at all. Let’s meet after lunch, once you have the data on hand, and I’ll explain then.”

Background

Veizenburg was new to dress-shirt making, yet few people in the world had a tailoring heritage as distinguished as his. Veizenburg’s grandparents and their families, Austrian Jews, had fled Vienna to escape the Nazi regime and World War II. Among other things, they left a clothing shop on the legendary Der Graben, one of the most famous streets in Vienna’s city center. A family business for generations, the shop was the ultimate destination for quality and craftsmanship and held the “k.u.k. Hoflieferant” designation, meaning imperial and royal court supplier.

Emigrating from Austria within a few months of each other, some family members ended up in Canada and others in the United States. They took whatever jobs were available, and the family shirt-making tradition seemed to have died. But some 70 years later, Timm, who was now approaching 40, became intensely interested in bringing back what the Veizenburg name had once stood for. In his childhood, Timm had been very close to his grandfather, and remembering those days inspired him to pursue this business venture.

Timm Veizenburg’s online storefront opened in 2011, and pop-up shops quickly followed, appearing in North America’s most prestigious shopping locations once or twice a year. Veizenburg was selling impeccably made men’s shirts.²

¹ LECs referred to Limited Edition Collections.

² A line of women’s shirts was added in 2015, after the events described in this case occurred.

This disguised case was prepared by Anton Ovchinnikov, Distinguished Faculty Professor of Management Science and Operations Management and Scotiabank Scholar of Customer Analytics at the Smith School of Business, Queen’s University, Canada; and Alexander Pyshkov, Research Assistant. Names, locations, and data in the case are disguised for confidentiality purposes. It was written as a basis for class discussion rather than to illustrate effective or ineffective handling of an administrative situation. Copyright © 2016 by the University of Virginia Darden School Foundation, Charlottesville, VA. All rights reserved. To order copies, send an email to sales@dardenbusinesspublishing.com. No part of this publication may be reproduced, stored in a retrieval system, used in a spreadsheet, or transmitted in any form or by any means—electronic, mechanical, photocopying, recording, or otherwise—without the permission of the Darden School Foundation. Our goal is to publish materials of the highest quality, so please submit any errata to editorial@dardenbusinesspublishing.com.

Business Model

Because he ran primarily an online business, Veizenburg directed his customer analytics group to analyze web publications and fashion magazines and shows (as well as the company's own site traffic) and target selected customers with personalized offers for dress shirts. The company did not advertise in traditional media; instead, it bid on search keywords, placed banner ads, and occasionally showed up at events that well-dressed men were likely to patronize.

Veizenburg effectively had two product lines. First were the “must-haves,” such as white or light-blue shirts, which were always “in the collection” in a variety of styles, fits, and sizes. Second were the Limited Edition Collections (LECs, mentioned above) which consisted of more creative, bolder-looking styles made with distinctive fabrics and design elements. These collections were available for only a short period of time (typically two to four weeks).

For both collections, the fabrics and accessories (buttons, linings, etc.) were sourced primarily from England and Italy. Veizenburg often accompanied the firm's designers when they visited the textile artists and mills to select the patterns and prints for upcoming collections.

Production took place in Eastern Europe, primarily in western Ukraine, around the city of Lviv. Ukraine, once a textiles powerhouse of the Soviet Union, had suffered an unprecedented drop in garment production of nearly 95% through the 1990s. But by 2013 it had emerged as a viable alternative to China and India for sourcing apparel production.³ It had the advantages of skilled labor, low wages,⁴ and a favorable location for small- and medium-sized orders, especially for complex garments like coats, suits, and shirts. Numerous fashion brands—Zara, Hugo Boss, J. C. Penney, H&M, and many others—outsourced their production to western Ukraine. As a result, a thriving textile cluster had emerged of over 6,000 firms, both large and small,⁵ often funded by foreign investments. The proximity to markets and the “made in Europe” label were clearly a plus, but the unstable political situation and erratic local regulations discouraged further development of the textiles industry in that region. In particular, most firms operated under the so-called “tolling” of materials, where clients imported precut raw materials and accessories, duty-free for a period of up to 90 days, and exported the sewed and packaged garments.

This is precisely what Veizenburg's firm did. All fabrics and accessories were imported into Ukraine, where its partners' capacity allowed up to 3,000 LEC shirts in the specified variety of styles and sizes to be made within a three-week period. The shirts were packaged in Ukraine and shipped by air cargo to the company warehouse on the East Coast of the United States. From there, the shirts were delivered by express post to customers. The total average cost of sourcing the fabric and accessories, producing a shirt, and shipping and handling raw materials and ready goods was \$65 per shirt.

Watson and the Data

Jason Watson had started working for Veizenburg the previous summer, after finishing his business degree. Watson liked being close to the leadership of the firm, and it was also important for him to be proud of what his firm was doing. When he presented the classy Royal Blue Fine Twill Spread French Cuff shirt to his father for Christmas, he was certainly proud.

³ http://www.just-style.com/analysis/ukrainian-apparel-industry-sees-revival_id93137.aspx (accessed Sept. 14, 2016).

⁴ Some publications argued that the wages were in fact too low. See <http://www.euractiv.com/section/social-europe-jobs/news/textile-workers-paid-lower-in-eastern-europe-than-in-china-report-finds> (accessed Sept. 14, 2016).

⁵ <https://cleanclothes.org/livingwage/stitched-up-factsheets/stitched-up-ukraine-factsheet> (accessed Sept. 14, 2016).

Per Veizenburg's request, Watson pulled the daily sales reports for all completed LECs from the company database and, anticipating the direction things were going, he also added the LEC identification number (LEC ID). (See **Exhibit 1** for the snapshot of the data, and **Exhibit 2** for a graph of the data.)

These data referred to the total units sold. As did most retailers, Veizenburg ordered specific sizes according to the size profile, which determined the percentage of items that had to be ordered in each specific size. The company was confident that it knew its target audience and, following the initial research, it established the size profile used for all LECs thus far. This meant that it was sufficient to determine the total number of shirts to order. Watson smiled as he thought about it.

The Markdown "Problem"

With the LEC project now in its second year, it had become apparent that many of the LEC shirts remained unsold. The company experimented with various tactics to clear this inventory. For example, selected customers were offered a "buy two, get one free" promotion. However, widespread markdowns as practiced in the retail industry were not considered, as they could tarnish the brand's prestige and reputation for high quality. With the limited promotions offered, the average net price per LEC shirt was \$135.

To help generate ideas for selling this inventory, Veizenburg hired a specialized consultancy. And although the consultants came up with several plausible suggestions, as Veizenburg sat through their presentation, he kept wondering why there was so much unsold inventory in the first place. He was convinced that the company could reduce the need for markdowns if it reconsidered procurement. He was looking forward to the discussion with Watson and the analysis of the data.

The Meeting

"This is Black Friday,⁶ right?" asked Veizenburg, pointing to the evident peak in **Exhibit 2**.

"Correct," Watson confirmed. "We built a forecasting model that predicts the sales of an LEC based on its planned duration, and we placed an order in Ukraine as per the model's prediction. The peaks you see correspond to the longest-duration collections, so we already account for them indirectly.

"And it's true that we somewhat overorder in Ukraine," he added. "With the delivery time of three weeks we have to; otherwise we risk running out of product, and we can't really reorder," he said, wrapping up his quick overview of procurement practice to date.

"I recall we considered local production at some point. What's the status of that?" Veizenburg asked.

"We did. We have a small local facility we use for custom alterations, and it is capable of producing 12 shirts per day for next-day delivery, starting perhaps one week from the LEC launch. The cost would be \$95, as opposed to \$65 in Ukraine, though, and that's why we decided not to use it," Watson answered.

"The \$95 sounds about right," said Veizenburg, nodding, "but I'm not sure we made the right call; we don't have to use the facility all the time. May I ask you to reconsider local sourcing?"

"Will do," Watson said, wondering at the back of his mind how exactly he would do it.

⁶ The day after Thanksgiving in the United States and one of the busiest shopping days of the year. See "Black Friday in the United States," Timeanddate.com, <https://www.timeanddate.com/holidays/us/black-friday> (accessed Sept. 21, 2016).

“There is another idea I want you to play with,” continued Veizenburg. “The business is not booming as much at our Ukrainian partners, and they would be able to turn around up to 1,000 shirts within a week, delivery included, at the same \$65. Might that be of interest to us?”

“That’s...a very good question,” Watson replied, stretching out his reply. He was even less sure how to analyze this additional flexibility. “How about I revisit the upcoming 21-day LEC, and then we can discuss. Give me a day.”

“Sounds like a plan. Glad to have you on our team, Jason!” Veizenburg sounded enthusiastic.

Exhibit 1

Outsourcing, Near-sourcing, and Supply Chain Flexibility in the Apparel Industry (A)

Daily Sales

(Left side shows the first 10 records and right side shows last 10)

Date	LEC ID*	Units Sold	Date	LEC ID	Units Sold
1/8/2013	1	40	2/21/2014	23	47
1/9/2013	1	5	2/22/2014	23	20
1/10/2013	1	14	2/23/2014	23	28
1/11/2013	1	8	2/24/2014	23	12
1/12/2013	1	4	2/25/2014	23	36
1/13/2013	1	13	2/26/2014	23	13
1/14/2013	1	9	2/27/2014	23	23
1/15/2013	1	8	2/28/2014	23	56
1/16/2013	1	5	3/1/2014	23	37
1/17/2013	1	5	3/2/2014	23	49

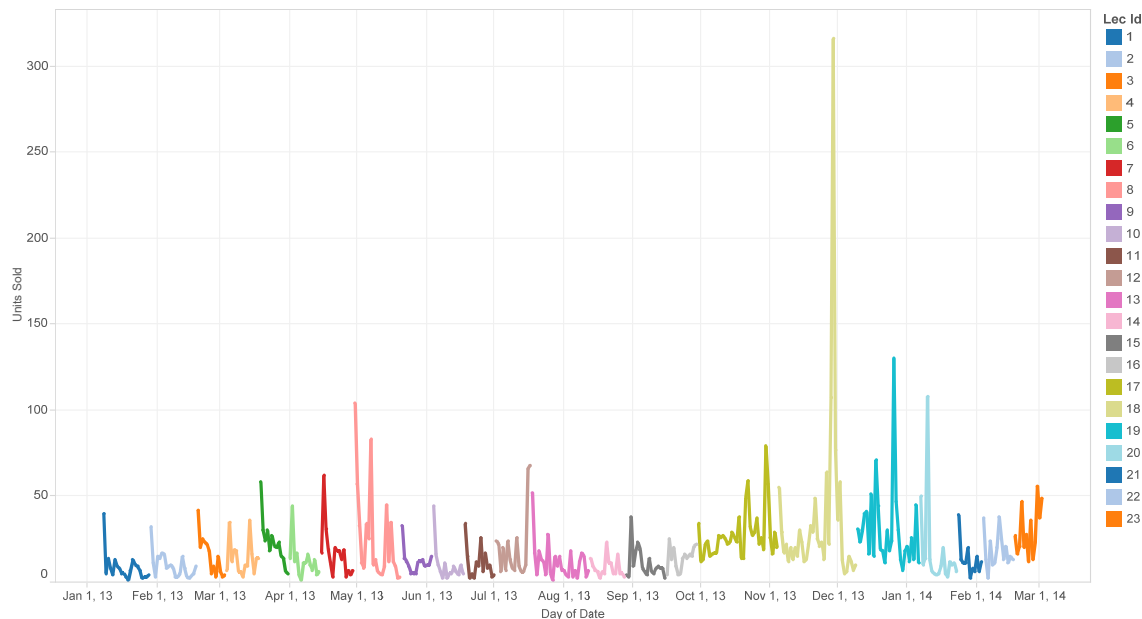
*Limited Edition Collection Identification Number

Source: Created by author.

Exhibit 2

Outsourcing, Near-sourcing, and Supply Chain Flexibility in the Apparel Industry (A)

Chart of Daily Sales by LEC ID*



*Limited Edition Collection Identification Number

Source: Created by author from the data in **Exhibit 1** using Tableau.