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BENBO (B): A BRAND OWNER with outsourced production

Gang Chen and Jingxuan Wang wrote this case solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

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One morning at the end of November 2013, the chairperson of Guangdong Cont Garments Manufacturing Company (Cont), Min Cai, and the general manager, Ke Lau, were sitting in a meeting room with production coordinator Meiyan Chen (Ayan) and order supervisor Si Cai (Asi). Ayan and Asi were responsible for coordinating with Guangdong Benbo Garments Company Limited (Benbo), a casual menswear brand owner. They were talking about how to respond to a compensation dispute in a negotiation meeting scheduled with Benbo that afternoon.

Cont was one of Benbo’s outsourcing manufacturers and made casual pants for Benbo. Cont had been late in delivering a large quantity of orders that year, and Benbo had declared that it had sped up its own production and used express logistics to meet the needs of its stores, which had led to considerable additional costs and unpredictable opportunity costs. A similar situation had occurred after the summer order placement meeting in August 2012. The number of delayed orders that time had been 50,000. In the first half of 2013, Cont and Benbo had organized a negotiation meeting to discuss how to allocate the losses. In the end, Cont had compensated Benbo for CN¥0.25 million[[1]](#footnote-2) in hopes of maintaining long-term co‑operation. Because the number of delayed orders had reached 150,000 this time, Cont had to prepare seriously for the negotiation meeting.

Cont: GARMENTS OUTSOURCING MANUFACTURER

Cont, a major modern garments manufacturer founded in 2005, combined costume designing, production, and sales. There were more than 2,000 staff members at its plant, which was over 35,000 square metres and supported a monthly output of 500,000 units. For all these years, Cont had been devoted to meeting the needs of its customers in the shortest time possible while maintaining quality. Cont’s products were well regarded in the field because of their guaranteed quality and punctual delivery, which were due to a large group of skilled workers, a strict management system, and a reasonable production arrangement. Cont worked for two main cooperative brand owners, Benbo and UCLOO, which accounted for 85 per cent of Cont’s orders.

Before 2012, Cont had used a mass production business model, but decreasing order size and a diversity of orders had driven Cont to produce in small batches and multiple styles with some advanced equipment. The new production model not only complicated workflow—leading to more demands on the workers’ skills—but it also required adjusted and reintegrated production lines to adapt to the production requirements of different styles, and this in turn resulted in higher costs and more requirements for field management and quality control.

Because the cost of labour in coastal areas of China had been increasing in recent years, the profits of original equipment manufacturer (OEM) enterprises were decreasing. The higher labour costs were eroding Cont’s profit, and as a result, Cai was thinking about strategic repositioning. Cont attempted to establish its own brand, Cont-ONE, to become an original brand manufacturer (OBM) enterprise and to improve profitability and competitiveness. Cont set up its own brand development centre to drive Cont-ONE to the market.

The core product of Cont-ONE was casual pants, given Cont was skilled in producing them. The styles of Cont-ONE casual pants were simple and neat; they were designed by famous domestic designers. Cont-ONE casual pants were brought to market in January 2013 and mainly sold in Guangdong. Unfortunately, the response from the market was not good enough. Cont-ONE failed to win a place in the competitive market. Cont’s own brand development centre predicted that Cont would lose about ¥3 million by 2013 on account of the failure of Cont-ONE, causing trouble for the company’s financial condition that year.

CO-OPERATION AND TROUBLE WITH BENBO

Benbo was a casual menswear brand owner. Casual pants, Benbo’s core product, sold well in the market. The profits from Benbo’s orders comprised 30–40 per cent of Cont’s total profit and therefore played an important role in Cont’s profit composition. Smooth co-operation brought larger and larger orders every year.

To determine orders for each year, Benbo held four order placement meetings, in January, March, June, and August each year. After each meeting, the season’s order quantities were released to Cont according to demand forecasting. The size of the casual pants orders Cont received from Benbo was different each season (see Exhibit 1).

Benbo sent orders to Cont each season based on previous orders, but the order sizes would usually be adjusted. The delivery time was approximately two months. The production cost of a single garment was about ¥50 for Cont, but it quoted prices according to market conditions. It usually charged about ¥80 per pair of casual pants. Emergency orders needed overtime work and led to increased production costs. Prices could even reach ¥120 per pair of casual pants during certain periods, such as before Christmas. There were two classifications of overtime work. One applied to normal working days and increased labour costs by 50 per cent. The other applied to holidays and increased labour costs by 100–200 per cent.

Benbo’s casual pants required many kinds of fabrics, and Cont purchased these from fabric suppliers designated by Benbo to produce different products. The company needed about 20 kinds of fabrics for casual pants every season. Only four or five of these would be reused the following season, and others would be re-selected subject to changes in the research and development design themes. Fabrics were chosen for different seasons based on feel, spinning process, density, and other properties (see Exhibit 2).

Cont had a specialized project team in charge of co-operation with Benbo, Cont’s primary client. This team was composed of a production group and a procurement group. Cheng Li, the group leader of the production group, was responsible for arranging the production of orders from Benbo. Gang Zhang, the group leader of the procurement group, was responsible for communicating and co-operating with the fabric suppliers designated by Benbo. The general leader of this specialized project team was Lau, who had two assistants, Ayan and Asi.

After the autumn order placement meeting in January 2013, Cont received an order from Benbo for an expected quantity of 480,000 pieces. However, the order was changed to 700,000 because of adjustments in sales forecasting and order quantities made by Benbo’s store clients, and the fabrics needed for the orders had changed greatly. Although Benbo had told Cont that the order size might be adjusted, and Cont had promised to catch up with the adjustments, the adjustment of orders made it difficult for Cont to purchase fabrics and produce the garments.

When Cont received the original expected order size, it had adjusted part of its production lines for the purpose of developing its own brand, Cont-ONE. Production lines allocated to Benbo had thus decreased compared to two years earlier. After receiving the actual orders, even overtime work and deployment of Cont’s production lines were not enough to bring the quantity of delayed orders below 150,000 pieces.

Benbo suffered significant losses due to the delayed order delivery. Benbo informed Cont that, to meet demand from the stores, it had accelerated its own production speed and used express logistics, leading to extra production and logistics costs. Some products arrived at stores after the best time for sales, resulting in unpredictable opportunity costs. Moreover, the hastily produced products may have had a negative effect on the brand because their quality was not guaranteed. Benbo received increased complaints from the stores because of the delay of orders, and this harmed Benbo’s business reputation.

Cont had received a call from Eva Liu, manager of Benbo’s procurement department, three days earlier. Liu requested that Cont compensate Benbo for the loss due to the delay of orders. The two companies arranged a negotiation meeting at Benbo’s meeting room to solve the compensation dispute over the delay of orders.

preparing for the Negotiation Meeting

The people in Cont’s meeting room looked serious. Cai, Lau, Asi, and Ayan were discussing how to handle the negotiation with Benbo.

“This is the second time we have had to negotiate compensation for delayed orders,” Cai said. “We’re faced with the same situation for a second time, and this time Benbo is asking for ¥1.5 million in compensation. Can you explain why?” Cai was obviously unhappy.

“It indeed looks awful. The anticipated order from Benbo changed enormously, and it was very difficult for us to catch up with their demand in terms of production,” Lau explained.

Ayan added angrily, “Early this year, Benbo ordered only 480,000 pieces. No one expected that this would be completely disregarded. We planned the production based on that figure, but Benbo’s actual order far exceeded that number. They made a mistake calculating, so they should take the fall. It is none of our business.”

“I agree with Ayan,” Asi said. “Cai, because of the Benbo order, our production department has worked overtime for many days. I know this well because I, myself, followed up Benbo’s order. The changes to the order made it difficult to readjust our production. There were different materials for the previous orders and the orders we have now. There was nothing we could do when the materials fell short.”

Ayan added, “Workers in the production department have been complaining. I often heard them whining about constantly working overtime.”

“Cai, this unpleasant incident with Benbo also serves as a reminder that we cannot always centre on OEM,” Lau said. “This will not last long. We should attach more attention to developing our own brand. The profits for OEMs are low, and we suffer as a doormat. If we can build up our own brand, our ability to make money and the development of our company will be greatly improved.”

“It’s not that we didn’t develop our own brand,” Cai pointed out. “We’ve been working on it, but the result is not promising. The financial performance of our own brand is terrible. Not only does the company not profit from it, we suffer great losses. This negotiation should be dealt with carefully. After all, we still need co-operation with Benbo. We cannot pay much though. The overall profit for the company is not looking good.”

Lau could not help but sigh. “We’ve been working on our own brand for the past two years, and we’ve suffered setbacks. In terms of profit, we cannot even match that of previous years. For this negotiation, even if we are to compensate them, we can pay no more than ¥1 million or there’s not going to be any value left in doing business with them. With labour costs increasing and profit decreasing, it’s getting harder and harder for us to do business.”

“My point is that we can compensate them but not the amount they ask,” Cai said. “Asi is right. We couldn’t produce when the materials were not there. We will see if we can break them in the negotiation based on this.” Looking out through the meeting room window, seeing workers by the plant busy with work against the winter sunshine, Cai was a bit lost in thought. “We must bear in mind the consequences that this compensation has on the long-term development of the company.”

The deficit of Cont’s own brand development department had reached ¥3 million, and the profit from OEMs was decreasing, whereas the brand owners had increased their expectations. It was very saddening to Cai that there had been two compensation negotiations over the year. Where did the core of the problem lie? How could he avoid similar problems from reoccurring? Were there problems deep in the strategic adjustment or the operations model? Cai felt anxious.

Exhibit 1: Proportion of Casual Pants Order Size FOR Each Season in 2013

|  |  |
| --- | --- |
| **Order Placement Meetings** | **Order Size (%)** |
| Spring | 19 |
| Summer | 24 |
| Autumn | 26 |
| Winter | 31 |

Source: Guangdong Benbo Garments Company Limited.

Exhibit 2: Fabric Properties and Differences IN Casual Pants FOR Different Seasons

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Spring** | **Summer** | **Autumn** | **Winter** |
| Number of fabric varieties | 18 | 20 | 20 | 16 |
| Number of conventional fabrics | 4 | 4 | 4 | 3 |
| Fabric compositions | Pure cotton fibre and blended fibres | Pure cotton fibre and blended fibres | Pure cotton fibre and blended fibres | Pure cotton fibre and blended fibres |
| Thickness | Mainly thin | Mainly thin | Mainly medium | Mainly thick |

Source: Guangdong Benbo Garments Company Limited.

1. CN¥ = Chinese yuan renminbi; all yuan amounts are in CN¥ unless otherwise specified; CN¥1.000 = USD$0.164 on December 31, 2013; all dollar amounts are in US$ unless otherwise specified. [↑](#footnote-ref-2)