



Eastern promise?

Fiona Walsh

Western retailers have turned to China and other South-east Asian countries to source goods and preserve margins. But while the cost savings can be huge, chasing the cheapest goods can raise challenges about security of supply and ethical issues, reports Fiona Walsh.

Competition on the High Street has always been cutthroat. But as retailers seek to cut prices and improve margins they have increasingly been forced to look to China and South-east Asian countries to source goods and cheap labour.

A recent UK government report showed that the price of women's clothes has dropped by 34% since 1995. Meanwhile, Chinese factories are now estimated to produce one fifth of all clothing sold in Europe, with suppliers at times undercutting their rivals' prices by 60%.

It is not just China that has benefited from Western retailers sourcing goods overseas. Vietnam, Cambodia, India – and countries closer to home such as Turkey and Kazakhstan – have seen a surge in output.

Dedicated suppliers of fashion

“Sourcing is of increasing importance because of the rising maturity of the retail trade, which has led to a slowdown in growth. Retailers' costs are rising faster than sales,” says Robert Clarke, research director at specialist consultancy Retail Knowledge Bank. “There is a greater focus on gross margins, which links directly to sourcing effectively.”

However, there are pitfalls. These include the time it can take for goods to arrive. A rushed order may have to be air-freighted, which means giving away margin. One solution is to have back-up capacity nearer to home – use Asian suppliers to provide the bulk of goods, but retain some flexibility of supply.

“Some retailers have adopted a very different model,” says Richard Bucknell of ISIS. “Inditex, the Spanish group that owns the Zara chain and is Europe's biggest retailer, produces nearly all of the clothes for its 2,700 stores from factories located in a remote corner of Spain. It also keeps a tight control of its supply chain. This integrated approach allows it to respond quickly to changing fashions.”

Clarke also says that other European retailers have bought some production back after deciding that speed of delivery outweighs the cheaper production costs.

Ethical concerns are another issue – and one which Chris Steed, co-founder of corporate finance firm Argyll Partners – believes will increase: “Customers do not want to buy clothes made in sweatshops and retailers don't want to sell them.”

Feet, food and fashion soldiers

Another threat is the imposition of import tariffs. This became a hot political issue recently when the European Union slapped a 19% duty on cheap shoe imports from China and Vietnam.

Bucknell adds: “This move came despite many footwear retailers believing that the imported product differs from that sold in the source country - so price comparisons around ‘dumping’ are invalid. With this protectionist theme having found favour with European regulators, the move has prompted the British Retail Consortium to launch a campaign to warn shoppers of steep price rises from jeans to furniture if import duty is imposed. Many retailers, including Tesco, are now looking to switch sourcing of footwear to Indonesia and Cambodia.”

Tesco has gained a huge competitive advantage from its Hong Kong-based global sourcing operations, allowing it to pile pressure on smaller and less efficient retail rivals, both in food and non-food.

Tesco has 11 sourcing offices around the world. In 2005, it sourced \$2.2bn of non-food products from China alone, including electricals, furniture, toys and clothing. Thailand accounted for \$140m worth of goods and India around \$90m, almost all clothing.

Spokesman Greg Sage says Tesco spreads its sourcing to balance the benefits of speed and price: “A fashion office in Turkey cannot compete on price. But it has advantages on speed, and we can get goods from the catwalk to the stores in four to five weeks.”

At Marks & Spencer, more efficient sourcing has been a key part of chief executive Stuart Rose's recovery strategy for the iconic high-street retailer. M&S once boasted about its home-grown supplier base, but has been forced to look east. Even so, it was probably the last major European retailer to set up its own direct sourcing operation in the Far East – an issue it addressed by opening a new Asian office in Hong Kong last September.

Shanghai surprise

However, doing business in Asia can be tricky and experience counts. For a start there are cultural differences.

Nayef Marar, one of the founders of Americana, owner of “edgy” fashion brands Hooch and Bench (favoured by Robbie Williams and Cameron Diaz), moved his centre of Asian sourcing from Hong Kong to Shanghai after Britain handed the colony back to China in 1997.

Marar recalls being surprised when he went to a restaurant one evening to be confronted by 80 cages of live snakes waiting to be cooked. The episode taught Marar the importance of understanding local tastes - so much so that he now employs a specialist cook at his factory. “If we didn’t do that, we’d have to give them money to buy lunch. It’s expected of employers.”

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What is clear is that local knowledge has been essential for Americana, whose “highly effective” sourcing operation was one of the attractions to ISIS Equity Partners when it backed the £20m buyout of the business in 2003.

Marar, who lives in Shanghai, claims that moving to the city was the “best thing Americana has ever done”. Americana started in Shanghai with just a couple of people and Marar admits that in the early days the quality of the goods was not great. Now, it’s second to none. The operation employs 30 highly qualified people, and a number of its 25 factories have become dedicated suppliers.

However, Shanghai is becoming more expensive, says Marar: “Setting up an office here is equivalent to the cost of somewhere north of 42nd St in New York. It’s still half the price of London, but more expensive than Manchester.

“We could source from anywhere we wanted. But then I’d have to have people running around the globe, staying in hotel suites, running up drinks bills. This is a reliable area where we are served well.”

Taste the source

While the rush is undeniable, new trends are emerging. One is relocation within South-east Asia, according to Mike Flanagan of Clothesource, which advises companies on sourcing strategies. “Now Europe has re-imposed quotas on China, we’ve got Vietnam and Cambodia popping up again. And there’s been a shift in Thailand. Factories are moving out of Bangkok to the provinces, where it’s cheaper.”

He says expert help is vital for smaller retailers sourcing from overseas: “You need to find an agent you can trust. If you’re small, forget all that nonsense about keeping out the middleman. You need him. Just keep out the bad middlemen.”

Establishing a partnership is also vital, says Steed: “We were working with a big retailer recently that wanted a toy hovercraft, for \$10 a go. They wanted the craft to actually hover – still for ten bucks a go. And the supplier delivered. Our client was knocked out by what they could do. Increasingly, it’s about what can be done together.”