USFIA Benchmarking Study Highlights Trending Sourcing Strategies, Cost Concerns and the ‘China Plus Many’ Model

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If one thing’s certain, it’s that the apparel industry is facing uncertain times.

Consumers are increasingly challenging to satisfy, retailers are reeling in the face of falling foot traffic and the need innovate on an almost constant basis, and many are falling victim to bankruptcy. Add to that the political uncertainty as the U.S. gets closer to presidential elections, and the whole industry is in flux.

But all that aside, the United States Fashion Industry Association’s (USFIA) 2016 Benchmarking Study still found that sector players are optimistic about the coming five years—92 percent of those surveyed see blue (or mostly blue) skies ahead for the industry.

The key standout in the study, however, is that the rising cost of sourcing is no longer the most top-of-mind matter.

For the first time since starting the study in 2014, domestic market competition ranked above increasing costs as the top business challenge in 2016, though increasing costs followed right behind at No. 2.

Why?

“It is likely that U.S. fashion companies are able to save dollars on various costs associated with sourcing and production thanks to a strong U.S. dollar against other major currencies, as well as the record lows in oil prices in the past few months,” the study noted.

USFIA president Julie Hughes said, “Because of the strong U.S. dollar and low oil prices in recent months *and* thanks to companies’ improved supply chain management, cost pressure this year becomes relatively less pressing. In comparison, as is widely reported including in SJ, e-commerce and fast fashion retailers (such as H&M and Zara), are increasing the pressure on many fashion companies and brands which rely on selling through traditional channels. So we are not surprised that ‘market competition’ is the top concern this year — with increasing costs ranked second.”

But domestic competition isn’t the only thing keeping apparel executives up at night—40 percent said international competitors are one of their top three restraints (after rising costs and domestic competition) on increased profitability this year, up 17 percentage points from last year’s survey.

Where companies are sourcing

Most companies are continuing to diversify their sourcing base this year, with 52 percent sourcing from 10 or more countries or regions. The apparel industry’s global reach is growing and respondents as a whole are sourcing from 56 total countries in 2016, up from just 41 last year.

“As the fashion industry is becoming more global and faster, it is increasingly important for companies to strike a balance between sourcing cost, speed and flexibility,” according to the study.

China still takes the top spot of most utilized sourcing destinations, with 100 percent of respondents making at least some goods there, followed by Vietnam (93 percent), India (81 percent), Indonesia (74 percent) and Bangladesh (70 percent).

Though costs are less of a concern, companies are still more actively seeking alternatives to China than they were last year.

The reason, according to Hughes, is because factories may want to take advantage of newly implemented FTAs like TPP or may want to further diversify their sourcing base to improve flexibility.

“Some of these changes may be driven by forward-looking companies who see that China’s textile and apparel industry is quickly evolving as well,” Hughes said.

China is moving toward making more technology–and capital-intensive textiles and less apparel in the years ahead, and the trend seems to be irreversible.

“It may sounds surprising, but more and more Chinese companies are making plans to move production to countries where there are lower costs,” Hughes said, adding that discussion about Chinese companies investing in Vietnam, Bangladesh, Cambodia and even Africa was abundant during a recent trip to Shanghai. “I think that this reality is reflected in the views that brands and retailers remain interested in new alternatives for sourcing, even if the price pressures in China are less than during the past two years.”

Bangladesh ranks the fifth most popular sourcing locale this year, a significant jump from 10th place and 50 percent usage last year. “However,” according to the study, “respondents seem to be more cautious about further increasing sourcing from Bangladesh over the next two years, with only 22.7% expecting an increase, much lower than the 42.3% expecting an increase in 2015.”

Sourcing from Trans-Pacific Partnership (TPP) and African Growth and Opportunity Act (AGOA) nations are gaining momentum. Eight of the 56 countries respondents source from are TPP partners (Vietnam, Mexico, U.S., Malaysia, Canada, Peru, Singapore and Japan), up from just five countries last year. The same five AGOA countries—Mauritius, Lesotho, Kenya, Madagascar and South Africa—made the list as last year, but usage rates are up. Five percent more companies are sourcing in Lesotho, for example. For TPP countries, sourcing in Malaysia is up 24 percent, Peru up 19 percent and Mexico up 13 percent.

“This suggests that the signing of TPP and the 10-year renewal of AGOA have started to affect companies’ sourcing decisions,” the report noted.

Perhaps contrary to common belief, however, companies are more conservative about Vietnam’s growth potential in the next two years than they were last year, owed largely to the uncertainty surrounding TPP’s ratification and concerns about whether the country can meet the agreement’s “yarn-forward” rules of origin.

Sixty-one percent of respondents said they’d increase sourcing from Vietnam at least somewhat, though only 4 percent expect it to be a strong increase compared to 21.4% in last year’s study.

Growth had been in the double digits in Vietnam in the last several years, and it comes as little surprise that the growth was not sustainable at that rate.

“Plus, now it is clear to companies that the implementation of the TPP will not happen right away. I think that many companies already recognized that the process of ratifying such a ground-breaking agreement would take months, and maybe years,” Hughes explained. “But for others, this is a more recent realization—both for TPP and for the EU-Vietnam FTA. So there does not need to be a rush to expand sourcing in Vietnam immediately.”

It will also be a while before certain major textile and apparel products will be able to qualify for the TPP Rule of Origin.

“Apparel ‘Made in Vietnam’ often contains imported textiles,” Hughes said. “Vietnam still has limited capacity to manufacture some textile inputs such as yarns and fabrics. Currently, China is Vietnam’s largest source of textile imports, followed by South Korea and Taiwan. But of course none of these countries are part of the TPP…at least not yet. The new investments are being made that will offer greater vertical integration inside Vietnam, but realistically it will take time."

How sourcing strategies are shaping up in 2016

Companies aren't putting all their sourcing eggs in one basket in 2016, and "China Plus Many" has become a commonly adopted strategy.

Though all respondents reported sourcing from China, 77 percent said "Made in China" accounts for less than 50 percent of the company's sourcing value or volume. As far as the "many" in the China Plus plan, Vietnam and other Asian countries typically account for less than 30 percent of the portfolio, and most other regions, like the U.S., South and Central America, Africa and Europe account for less than 10 percent.

When it comes to sourcing models, 78 percent of respondents are direct sourcing from a selected supplier and mill using the company's own designs and selecting fabric from the mill resource.

Apparel companies are looking to suppliers to have the capacity to supply or manage sourcing for textile inputs and raw materials.

One executive surveyed said, "We specify fabric, our suppliers place orders with mills. We buy a package deal." Another said, "Suppliers manage the fabric/raw material sourcing and we approve."

What's happening with sourcing costs?

Rising sourcing costs will likely always be a concern in the industry, but this year, it seems, cost pressure is less pressing, as USFIA puts it. Seventy-four percent of respondents think sourcing costs will increase modestly or slightly this year, but none see any substantial changes on the horizon—20 percent even think their sourcing costs will go down this year, compared to just 7 percent in 2015.

Labor costs will lead any increases, followed fairly closely by costs for compliance with trade regulations.

"This result is a reminder that more needs to be done to continue eliminating trade barriers and cutting 'red tape' at borders to help companies manage and reduce costs," according to the study.

Increasing costs of raw materials, shipping and logistics are of the least concern this year, likely owed, again, to the strong dollar and low oil prices. Thirty-percent of respondents said their costs in these areas would decrease this year.

Compliance concerns on the rise

Trade policy has become increasingly important—namely compliance with trade regulations and trade protectionism risk.

Recent changes including the implementation of the Automated Commercial Environment (ACE) system for imports, constant confusion over Made in USA labeling and laws like California's Prop 65 have fueled concerns about keeping up with regulations.

"More complicated trade rules could lead to these growing concerns about trade compliance," according to the study. "And for the first time in recent memory, the candidates for the two major presidential parties in the U.S. presidential election have made comments that are, at best, unfriendly to trade and imports, and at worst, protectionist and xenophobic, which may also add to respondents' concerns."

Emerging trends in sourcing

There are five major trends to watch in sourcing this year.

- U.S. fashion companies will continue to adjust their sourcing bases, and for 44 percent of them that will mean further diversification and for 30 percent, greater consolidation. Either way, 90 percent of respondents said the next two years would see sourcing strategy changes at their companies.
- Though more companies are seeking alternatives to "Made in China," China won't be losing its top spot as a sourcing destination any time soon. Only 4 percent said their sourcing volume from China would decrease strongly over the next two years.
- U.S. companies will source more from Vietnam and Bangladesh in the next two years but imports from both countries will grow at a slower pace.
- Myanmar, Ethiopia and Cuba could provide potential sourcing opportunities for U.S. companies. Slightly more than one-fourth of respondents have already started exploring sourcing opportunities in Myanmar and Ethiopia and 4 percent have begun looking into Cuba.
- Ethical sourcing and sustainability will be given more weight in U.S. companies' sourcing decisions. Eighty-nine percent of respondents say ethical issues are more important to their sourcing decisions in 2016 than they were five years ago.