FLASH REPORT

TEN TAKEAWAYS FROM THE 2016 SOURCING JOURNAL SUMMIT

1) **Process improvement can be the most impactful supply-chain change, because this area of investment is feasible to retailers of all sizes. Simple adoptions of new supply-chain management systems can significantly improve efficiency. For example, migrating supply-chain management from basic Excel sheets to an end-to-end web-based platform has helped retail companies achieve real-time visibility into their supply chain.**

2) **Automation in manufacturing is still not yet scalable, given potential cost barriers. However, the potential implications over time are significant.**

3) **China maintains sourcing competitiveness through improved productivity and a shift toward higher valued items.**

The Fung Global Retail & Technology team attended the Sourcing Journal Summit in New York City on Tuesday, September 20, 2016. The summit is an annual gathering of supply-chain executives and top thought leaders in the field. Approximately 300 industry professionals attended the half-day event.

Ten key takeaways from the event are:

1) Process improvement can be the most impactful supply-chain change

Several speakers expressed the need to reduce inefficiencies in retail supply-chain management. It is feasible for retailers of all sizes to make an investment in this area, unlike cutting-edge automation in manufacturing, which requires more significant investment. Angela Chan, Senior Vice President and Chief Sourcing Officer at Destination XL, shared her company's experience in migrating its supply-chain management from basic Excel sheets to an end-to-end web-based platform. The technology upgrade

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allowed her company to have real-time visibility into their supply chain. She is now able to evaluate vendors in terms of delivery time and product quality on a monthly basis.

John Thorbeck, Chairman at Chainge Capital, a speed-to-market analytics provider, said that automating the current system without improving processes will eventually force the system to a breaking point. Updating the old supply chain with more automation is not an innovation strategy.

2) Factory automation is not yet scalable, given the high cost

Keynote speaker John Cheh, Vice Chairman and CEO of Esquel Group, a Hong Kong-based textile manufacturing company, showcased the latest innovation at his factories in China, including spinning mill automation, robotics assembly lines and smart quality-control systems.

Jose Suarez, owner and Managing Director at Impactiva, a global quality assurance services firm, pointed out the high costs of factory automation. In some cases, a robot can cost US$20,000-30,000 to deploy. Only big companies can rationalize the investment in this kind of technology at this early stage. When the cost drops to US$5,000, Suarez predicted the technology could make sense to deploy on a more mass scale.

3) China maintains sourcing competitiveness

China's labor costs have increased 10-15% per year over the past few years. On a per-unit basis, however, China is still highly competitive in terms of labor costs, according to John Cheh. The country has stayed competitive in sourcing by improving labor productivity through training and the use of more advanced manufacturing equipment.

The sourcing industry in China has also shifted towards higher priced items in which labor costs comprise a smaller fraction of the total production cost. The comparative advantages of Chinese sources are now in textile, design and the country's large production capacity.

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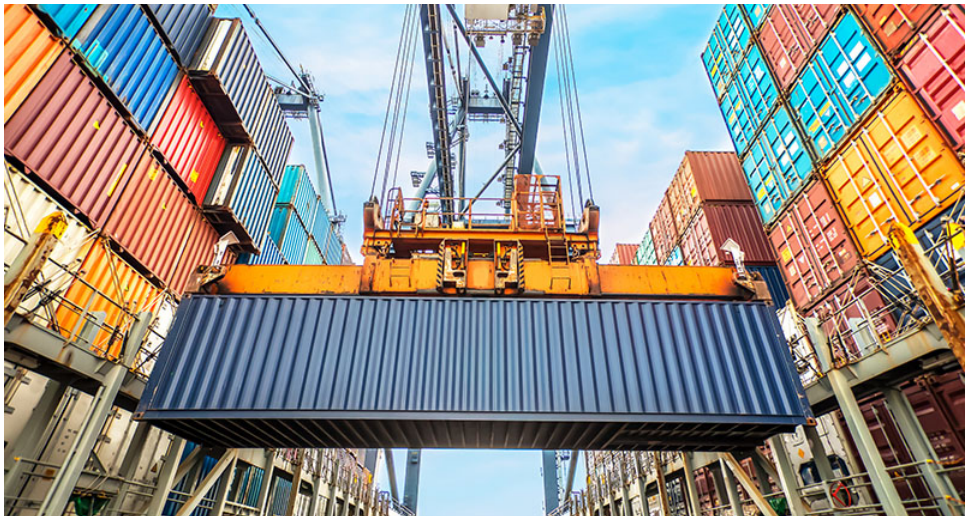
4) Nearshore sourcing in the Western Hemisphere presents an opportunity

Sourcing in the Western Hemisphere is an emerging trend that helps retailers improve speed to market. The retail supply chain has to adapt to the, "see now, buy now" consumers who demand on-trend products in real time. Sourcing in the Western Hemisphere can shorten lead times from several months to three to five weeks for certain categories. Communication with factories and faster product delivery time allows retailers to replenish inventory based on real time sales performance and has the potential to minimize markdowns.

5) The Hanjin bankruptcy is "controlled chaos" for retailers

Andrew Samet, Principal of Sorini, Samet & Associates, a DC-based consultancy that specializes in trade issues, provided an update on the recent Hanjin bankruptcy. He described the current situation as "controlled chaos." Retailers understand their exposure and are seeking alternatives to ensure timely shipments ahead of the peak holiday season. Besides cargo stranded at sea, the bankruptcy drove up international shipping rates by about 45%, year over year, Samet said.



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6) Retailers could benefit from an additional focus on sourcing

Edward Hertzman, Founder and Publisher of the Sourcing Journal, pointed out that retailers pay too little attention to inefficiencies in supply chains. Supply-chain efficiency is hard to track due to the lack of quantified metrics.

The traditional retail supply chain is part of over-processed organizations where design decisions must go through layers of approvals. This slows down the speed to market for retailers. Fast-fashion companies tend to have cultures that empower middle management to make fast decisions and this speeds up time to market.

Another challenge in the retail supply chain is the lack of competition. Retailers' overseas offices have little incentive to explore new factories and suppliers.

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7) A new normal for sourcing

John Cheh, Vice Chairman and CEO of the Esquel Group, described the new normal for global sourcing as adopting an integrated approach. Sourcing strategies should not focus solely on short-term variables such as lower labor and raw materials costs. Plans should consider all costs of doing business including quality assurance, returned orders and the political stability of sourcing destinations.

Philip Poel, Vice President for Global Manufacturing and Quality at Under Armour, said the true costs of sourcing are what show up on the financial statements as the costs of doing business rather than per-item unit sourcing costs.

8) Suppliers face new challenges

Major supplier countries such as China, Russia and Brazil have experienced a slowdown in gross domestic product (GDP) growth, with the exception of India. In the case of China, the country's annual GDP growth has slowed from high double-digits in 2007 to below 7% in 2016. Something fundamental has changed, according to the keynote speaker, John Cheh. This looming economic backdrop affects sourcing from both the supply and demand side. In particular, wage inflation in supply countries and deflationary apparel prices have squeezed margins for suppliers.

9) DNA testing improves quality

Dr. James Hayward, President and CEO of Applied DNA Sciences, a DNA testing provider for the supply-chain industry, introduced the application of DNA testing in retail supply chains. DNA testing for cotton products, for example, can differentiate Acala cotton from Egyptian cotton, which eliminates the controversies around product quality. During a shortage, DNA testing can identify the best substitute and recommend alternative solutions. The ability to trace fabrics to their country of origin also helps combat the use of conflict cotton, a source of income that finances wars in many regions.

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10) The outlook for international trade negotiations is optimistic

Steve Lamar, Executive Vice President at the American Apparel & Footwear Association (AAFA), is optimistic the Trans-Pacific Partnership (TPP) will pass this year. He stressed the importance of supportive voices from the industry and urged retailers to push for the passage of this free trade agreement. Bill Jackson, Assistant US Trade Representative for Textiles, highlighted Vietnam among the TPP member states as an opportunity for US retailers who want to invest in retail sourcing. The country is now the second-largest supplier of apparel to the US after China. The implementation of the free trade agreement in a few years will accelerate the return on investment (ROI) by retailers in Vietnam. Jackson is also optimistic about the ongoing negotiation of the Transatlantic Trade and Investment Partnership (T-Tip), the new trade and investment agreement between the US and the EU.

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