

Fashion Industry Struggles Over Pricing

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Shipping capacity is down, sending rates up sharply.

Photo By Sean Gallup/Getty Images

The tug-of-war is on.

On the one side are fashion and accessories producers struggling with inflationary pressures brought on by higher raw material, production and transportation costs. On the other is the dispirited consumer reluctant to make discretionary purchases and looking for deals wherever they can be found.

The consumer still holds the upper hand, given the weakness of the global economic recovery. The question is: How long can manufacturers and retailers hold off raising prices and, if they do, will they scare the skittish shopper away?

The battle mirrors the one going on among financial experts as the Federal Reserve squares off about the risks of inflation brought stalled economic recovery. That debate is likely to become more heated because of the disclosure that gross domestic product expanded 2.4 percent during the second quarter, a level considered too low to have an appreciable effect on the nation's 9.5 percent unemployment rate.

In fashion circles, inflation already has taken root. Costs are rising in virtually every link of the supply chain with little respite in sight. Reduced capacity, itself an outgrowth of the recession, has lifted prices for a variety of yarns, fibers and textiles. Finished goods have equally been hit by reduced capacity, as well as by a persistent push for better wages among factory workers in China and, now, Bangladesh. Scores of mothballed ships have meant fewer are available to cross the sea, driving up the cost and extending the time required to ship products over water.

Alternatives so far have produced little in the way of relief. Air shipping speeds up the process but only adds to the cost. Moving production to areas outside the busiest Chinese hubs to less-developed areas inside and outside China adds to the uncertainty of quality and delivery, and vendors and vertical retailers are loathe to bastardize their products at a time when vendors are fighting for every square foot of retail space, and retailers, for every available consumer dollar.

Rick Darling, president of LF USA, the U.S. subsidiary of Hong Kong-based Li & Fung Ltd., told WWD, "I think as a general trend we are now in a very long period of price inflation on the cost side that will most likely begin to stabilize itself sometime maybe in 2011. But between now and 2011, it will be pretty dramatic, and unfortunately, it is coming at a point in time where consumers really aren't particularly receptive to those price increases."

Added Spenser Alpern, chief executive officer of HMS Productions Inc., which markets better department store brands such as Cable & Gauge: "We see freight going up roughly 300 percent; raw materials, anywhere from 10 to 20 percent depending on the item; labor, roughly 10 to 15 percent, again depending on the category, and we are estimating dollar depreciation versus the Chinese currency of somewhere around 3 percent this year. In aggregate, this translates into somewhere between 5 percent and 10 percent increases overall.

"Unfortunately," he added, "this isn't the best economic environment in which to be raising prices. At the same time, it's never wise to scrimp on any part of the product, including design."

Explosive economic growth in China has forced entire industries to move farther inland to find cheaper labor. Following China's lead, Bangladesh in late July established a wage board that, following a strike by thousands of apparel workers, nearly doubled the company's minimum wage.

Darling said cotton prices have started to "stabilize" after nearly a year of escalation, but he's alarmed by other raw material trends.

"There are still pretty serious increases of 40 to 50 cents a foot for better leather, which is dramatic," said Darling. "I think footwear and accessories are going to be more challenging than apparel."

Both categories performed better than apparel during and since the recession.

Darling noted markets like Indonesia are being looked at "more seriously" in the quest for more affordable production, and Bangladesh remains "extremely competitive" despite its higher wage, which remains below China's in many cases.

In the meantime, the overall effect of these increases is hard to gauge and will vary depending on the relative strength of individual businesses.

"The more commodity focused your product is, the more fixed you are into a price range," said Jeff Edelman, director of retail and consumer products advisory services for RSM McGladrey Inc. "Those with pricing power will benefit, such as Coach, which can style around it; Nike because of its brand power, and Polo Ralph Lauren for product outside of the basic polo shirt."

Although he already sees some signs of moderation in cotton price increases, Jones Apparel Group Inc.'s ceo, Wesley Card, believes that rising prices will fall into two categories: blind increases for select fashion items that can carry a higher price and still offer the consumer value, "generally very well accepted by the consumer," and some boost in prices for commodity products to preserve "margin for both ourselves and our retail customers."

Jones has shifted some production to markets such as Vietnam and Bangladesh, but its knitwear and footwear still come primarily from China, Card said.

Retailers managed their way through the recession by keeping a laser focus on their inventory levels and managed to protect their margins despite top-line erosion going back as far as late 2007. But many relaxed their approach to inventory constraint in anticipation of an uptick in sales this year and are already eyeing their stock levels warily. They are understandably reluctant to do anything that will retard the already-unspectacular pace of consumer spending.

Neal Black, ceo of men's wear retailer Jos. A. Bank Clothiers, said, "Passing the higher costs on to consumers is what we all do in an inflationary cycle. We are always testing the willingness of our consumer to accept inflation. If they won't accept it, then we will go to something in between while we figure it out.

"Eventually, it has to go to the consumer," he concluded.

He had no specific plans to trim costs to protect margins and said the chain is "always validating our company-wide expense structure for efficiency. We will stay with the current structure as long as we can continue to grow sales."

Nor is he contemplating a reengineering of products to save money. "If our quality and value equation remain strong, then we'll make up for weak consumer spending by taking market share," Black said. "We're happy to get a bigger piece of a smaller pie."

Larry Fox, managing director at Karabus Management, a subsidiary of PricewaterhouseCoopers LLP (PwC) in Canada, believes that, with prices moving up and consumers hardly flocking to stores, some effect on margins is inescapable.

"Retailers will have to give back some of the incremental margins they were making in private label, and manufacturers will have to act in the same way," he said. "Both would have to initially absorb some of the costs, and they'll try to offset this as much as possible through alternative sourcing structures, [but at some point] I don't see how they can avoid pushing the costs through to the consumer."

He said the purveyors of luxury products, catering to a less price-sensitive clientele, are likely to pass along the cost increases to the consumer "sooner rather than later."

Fox explained that every firm has its own specific initial markup for each brand or label, and while that probably provides a bit of leeway to absorb some incremental costs, it's only so long before they are no longer able to hold down the pass-along. That's because firms, if they haven't already sought out lower-cost suppliers, can't shift their supply structures overnight, Fox concluded.

To many, a little bit of inflation in the apparel sector wouldn't be such a bad thing. Factors such as weak demand and the "Wal-Mart effect" have depressed prices since 1992. According to Commerce Department figures, they've fallen every year but two since then, and they did rise, albeit just 0.6 percent, in 2009. But they remain, on average, 20.4 percent lower than they were 18 years ago.

Deflation has made the achievement of same-store sales gains all the more difficult — more units of lower-priced goods need to be sold to even match year-ago performance — and, with consumers so accustomed to prices that rarely, if ever, go up, one result is a reduction in stores' and vendors' price elasticity.

In a research note, retail analyst Michael Exstein of Credit Suisse noted that "apparel cost inflation [is] not necessarily a driver of gross margin performance." He concluded, "Although cost inflation is something to keep in mind as one thinks about whether the current gross margin performance is sustainable, we believe the more critical question is whether the industry can keep its discipline of the last two years in terms of managing inventory conservatively to keep sales growth from exceeding inventory growth."

Heath Golden, president and ceo of Hampshire Group, isn't especially alarmed by the higher costs of production or transportation. He said long-standing relationships with key suppliers have helped the sweater and sportswear firm hold the line on prices for now. It's absorbing higher costs and shipping by air when necessary to get goods into the stores on time.

The biggest issue he's facing, however, is the "turmoil in the yarn market. Our factories are reporting that spinners are tearing up commitments and holding yarn for the highest bidder as prices rise. This is creating delays early on in the supply chain. We are largely recovering, but in the few instances where we're not able to do so, it is far more often than not traceable back to late yarn deliveries.

"Concurrently, we are actively formulating our sourcing strategy for 2011, as there are already rampant signs of continued instability in the cotton, yarn and labor markets. We are having productive talks with our key factories, and I am optimistic that we will head into 2011 with a sound strategy," he told WWD.

U.S. textile firms have been hit with dramatic price increases and are being forced to absorb the higher costs or find substitutes, which is putting a squeeze on their already-thin margins. The National Council of Textile Organizations and 74 U.S. textile companies, in a letter to House and Senate leaders in May, said: "Over the last six months, prices for acrylic fiber have increased 50 percent. If this situation continues further into 2010, the viability of our mills and workers will be put at risk."

Bob Miller, senior vice president of National Spinning Co., based in Washington, N.C., said acrylic fiber prices have increased as much as 60 percent, forcing the yarn spinner to find substitute fibers, such as polyester in products such as hosiery. Miller said one of the driving forces behind the increases in raw material prices was a perceived shortage of chemicals, combined with systematic power outages in China, which led traders to buy chemicals on the open market, in turn

driving up the prices. National Spinning purchases 25 million pounds of acrylic fiber a year, and a price increase of that magnitude hurt the bottom line.

"There was sticker shock in yarn, and we weren't able to pass the price increases as quickly as they were coming to us," Miller said. "We have still not fully recovered from the price increase."

Miller said the company has been able to offset the cost increases with stronger business in uniforms and less trendy products.

"The only way this year will be salvaged for many users of synthetic fibers is if prices drop in the second half of the year, and I am optimistic that there will be some decreases, but it is far from guaranteed," he added.

Laurel Berman, founder and designer of Los Angeles-based contemporary brand Black Halo, said she has no option but to shell out the cost for shipping fabrics from mills in Germany, Italy, Turkey and France by air to Los Angeles, where she manufactures her entire line. Not only do the mills refuse to use ocean freight, but retailers also are placing their orders closer to the shipping deadline, forcing her to ship by air, she said.

"It's the hardest part of our job, but I won't sacrifice it because it's what sets us apart," Berman said.

She has maintained her policy of sticking to a budget of \$22 or less a yard for textiles.

"The customer is used to us being at a certain price point," she said. "They expect our dresses to retail for under \$400. We've painted ourselves into a corner."

Chachi Prasad, ceo and creative director of Bishop of Seventh, a Los Angeles-based premium denim brand, said any deviation in prices could spur customers to jump to another brand. "There's not a lot of brand loyalty right now," he said. "Customers are trying to stretch their dollar."

Prasad said his company, too, is extending its options by experimenting with different materials. In reaction to price hikes for aluminum, copper and brass that are used to trim Bishop of Seventh's tailored jeans, he's developing buttons out of plastic and is considering less expensive materials including corn, wood and leather for trims. He stopped short of blending cotton with a rayon fiber called Cupro, Tencel or cashmere, as other designers have in an effort to balance the rising cost of cotton.

"You really can't substitute cotton," he said. "The innovative stuff is catchy and it'll stay a couple of seasons, but it'll fade and it doesn't have longevity. People are used to buying denim a certain way, and they'll always buy that way."

Kill City, a young contemporary denim brand in Los Angeles that retails from \$70 to \$160, has tried a combination of tactics to offset price increases for raw materials. In some cases, it absorbed the higher costs and thus eroded its margins.

"Sometimes we'll cancel a product because it's not worth it and it's not selling well," said Drew Bernstein, Kill City's founder and ceo.

As ocean freight costs have risen and factories in China have either closed or been unwilling to fulfill its orders to make as little as 300 dresses or jackets, Kill City has gradually shifted more production to the U.S.

"The problem I'm seeing is the lack of willingness and availability of suppliers to do quality stuff," Bernstein said. In one instance, a factory in China canceled its agreement to make samples for Kill City a month after receiving the materials and specifications.

Apparel manufacturers also face a critical challenge in finding space for their goods on ships. While carriers have raised rates and surcharge fees, capacity and reliability are creating major headaches for companies. As demand has recovered in recent months, cargo space on ocean freight ships hasn't kept pace, enabling carriers to increase rates and surcharges.

"The majority of cargo is moving, but it's much more difficult to find space and get confirmed space," said Hubert Wiesenmaier, executive director of the American Import Shippers Association.

Most of the vessels that were idle during the economic downturn are back online, sourcing executives and experts said, but carriers continue to "slow steam" them, move them at a slower rate, in an effort to cut costs. The move also keeps capacity low and further exacerbates cost issues.

The short-term effect of a shortage of freight containers has been disruptive from the perspectives of both timing and price. But Emanuel Weintraub, of the consulting firm that bears his name, noted that, while shipping costs have in some cases tripled, there is some relief in sight as new ships, each with “the capacity to hold 9,000 44-foot containers,” are coming online.

Further complicating cost dynamics for apparel companies is a pending decision about domestic trucking rates. The Commodity Classification Standards Board of the National Motor Freight Association will consider a proposal in October to change the classification for apparel based on density, a move that could ultimately result in higher trucking fees. The American Apparel & Footwear Association said the reclassification could lead to freight rate increases between 25 and 300 percent, depending on the category.

But importing apparel over water remains the key, and there is reluctance to increase capacity in a weak economic environment.

“Shipping companies are loath to increase the amount of capacity they put out on the water until they know demand has fully recovered,” said John Scholle, senior economist with IHS Global Insight.