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## **Kadgee Clothing**

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### **Clothing manufacturing in Europe**

Since the 1960's there has been a decline in the number of UK and European clothing manufacturers due to competition from cheaper, and sometimes higher quality, imported clothes. The clothing industry generally has become much more fashion conscious and price sensitive. This has led to a reduced number of companies that are still in business in Europe. Some companies have moved all or part of their manufacturing processes to other countries to achieve a cheaper operating base, and up until recently this has allowed them to continue to compete on price.

Many companies have had contracts to supply High Street retailers for over four decades and are highly dependent on retaining these key customers who wield immense buying power over the small manufacturers. A number of family owned manufacturing companies, that had been highly profitable once, have ceased trading, or are operating at very low margins, as a direct result of the High Street retailers being able to dictate terms of business and prices.

An additional factor that has put the main High Street retailers under more price pressure has been the appearance and market growth of new High Street retailers and their new brands, who have procured their goods mainly from overseas sources.

The result is that the few companies that are based in the UK and Europe which are left in the business of clothing manufacturing have to look very hard at their strategic plans in order for them to manage to maintain their business over the next few years.

### **History of Kadgee Fashions (Kadgee)**

Kadgee was formed in post World War Two in a European country, and has remained as an unlisted company, although its shares are now held by others outside of the founding family. Kadgee quickly established itself as a high quality manufacturer of both men's and ladies clothes. It had no difficulty selling its products to retailers, as the demand for ready-to-wear clothing was very high during the 1950's and 1960's.

By the 1960's Kadgee had a turnover equivalent to €25 million, and had nine factories operating in two European countries. The founder of Kadgee, Bruno Burnak, wanted to expand the manufacturing base and introduce new machinery, but the then Sales Director had considered that the company should continue to establish a stronger customer base before Kadgee expanded and invested further. Each of Kadgee's factories then employed between 70 and 100 employees, who were mainly female employees, with many working part-time. Some of the employees had a range of specialised skills and were considered to be very experienced. Kadgee's Head Office was run by the then Managing Director, Anton Kramer.

During the late 1960's Kadgee suffered its first major fall in sales, and found that it had large stocks of men's clothes that had been manufactured without specific sales contracts. Kadgee managed to sell off some of the stocks, albeit at below cost price. However, the management decided that it should not manufacture clothes without a firm contract from a retailer in future. The company had been caught unaware and had believed that the previous high demand for its products would continue.

In the early 1970's the range and design of its men's clothing was changed several times, but it continued to make little profit. In 1973, Kadgee sold its men's clothing range and designs and some of its manufacturing equipment to a large listed company. Kadgee decided to concentrate

on expanding its ranges of ladies clothing to meet the growing demands of its main customers. The reduced range of clothing, following the termination of all manufacturing of men's clothing, necessitated closing three of its factories. This left Kadgee with six factories operational in 1973.

During the next few years, Kadgee consolidated its position and its profitability increased again. In the early 1980's its then Chief Designer persuaded the Managing Director to expand its clothing range to include a range of girls' clothes. This new limited range was launched in 1982 and was immediately sold out, as many of Kadgee's customers realised that there was a demand for well designed and well finished children's clothing. Kadgee has positioned itself at the upper price range of clothing, and has never tried to mass produce low cost clothing.

During the 1980's Kadgee continued to expand its ranges of ladies' and girls' clothes, but retained the same manufacturing base of six factories. New equipment had been installed and the overall manufacturing capacity at the six factories had been increased by over 20% due to new sewing and packaging machinery. A further change that occurred was that many of Kadgee's customers were starting to dictate the styles and types of clothing required and Kadgee's designers had to manufacture to customers' specifications.

However, during the 1990's Kadgee suffered a number of setbacks. It also saw many of its competitors suffer losses and some to cease trading. Kadgee had been able to stay profitable only because of its particular customer base and because it sold high quality clothes that commanded a premium price. However, Kadgee saw its margins on many product lines reduced greatly and also it started to lose many of its smaller customers, who choose to import, at much lower prices, clothing produced in Asia.

### **Kadgee's shareholders**

Kadgee has remained an unlisted company and at the end of 2005 its shares were held as follows:

	<i>Shareholding</i>
Bruno Burnak	29%
Andrin Burnak	29%
Anton Kramer	10%
Dieter Stutt	8%
Frankie Bayane	2%
Andre Schnaffer	10%
Employee-held shares	<u>12%</u>
	<u>100%</u>

### **Kadgee's customer base**

Kadgee manufactures clothing for a number of European and international clothing retailers, including many well known High Street retailers. It manufactures clothing in the medium to higher price ranges and its customers require top quality designs and finishing to maintain their brand reputation. Kadgee has several contracts that were established over 40 years ago, although it has two contracts that have been secured within the last 10 years. Kadgee still manufactures ladies' and children's clothing for two retailers who had selected Kadgee in the 1980's, when the children's range had first been launched.

The majority of Kadgee's clothing is manufactured for its customers under the customers' own label, for example, clothing manufactured for one of its customers called Portrait is labeled as 'Portrait'.

### **Human Resources**

In the clothing manufacturing business one of the most crucial aspects to achieve customer satisfaction is quality. Kadgee has been very fortunate in having a skilled, very dedicated workforce who have always adapted to new machinery and procedures and have been

instrumental in suggesting ways in which quality could be improved. This has sometimes involved a very minor change in the design of a garment and the designers now work much more closely with the operational staff to ensure that the garments can be assembled as quickly and efficiently as possible.

The employees include a number of very talented people, whose skills are highly valued by the management team at Kadgee. There are five very highly skilled sewing machine operatives whose parents previously worked for Kadgee and they have passed their skills on. The machinery that is used to sew garments is very sophisticated but it is always the skills of the machine operatives which can make the difference to a finished garment. Additionally, Kadgee has always completed certain finishing touches by hand and this quality is appreciated by its customers. Kadgee is dependent on the skills of its employees to continue to deliver the same high quality on which it has established its reputation.

### **Losses made by Kadgee**

Kadgee has suffered from falling operating profit margins due to the pressure exerted by its customers over the last ten years. For the first time in Kadgee's history, it experienced losses for five years starting in 1998 through to, and including, 2002. During this time Kadgee increased its loans and its overdraft to finance operations.

During 2001, the company invested in new IT solutions enabling its customers to be able to track all orders from the garment cutting process right through to completion of garments and through to the delivery to customers' premises. The IT solutions also enabled Kadgee to monitor its production processes including machine usage, wastage at various stages of production and speed of production through the various stages. This has enabled Kadgee's management to reduce areas that did not add value to the finished garment. The use of TQM throughout the business has also increased Kadgee's efficiency and enabled it to eliminate some other areas which did not add value to the finished garments.

While margins are still low, Kadgee has been operating profitably again since 2003, albeit at lower margins to those achieved in the past.

Kadgee's employees have also taken an active role in increasing the throughput of garments and speeding up the manufacturing process. In fact, many of the changes made were at the instigation of key employees, who understood the actual processes and were able to identify where there were bottlenecks which caused delays. The reasons for the delays were reduced, leading to a faster manufacturing process. This enabled Kadgee to increase its annual number of garments manufactured from 8.25 million in 1998 to 10.9 million in 2005.

The consequences of some of the changes meant that some employees were made redundant at Kadgee's factories, and these were often part time workers, who worked fewer than 16 hours per week. The Kadgee management team fully understood that many of its skilled employees are female and that they do not wish to work full-time. However, Kadgee now do not employ anyone for fewer than 24 hours per week, and over half of the employees in the factories now work full-time.

### **Loss of sales contract with Forum**

Forum is one of Kadgee's key customers and in 2005 generated revenues of €16.8 million, which is almost 23% of Kadgee's total revenue however the operating profit on sales to Forum has been severely eroded over the last few years, with some product lines barely generating a positive margin at all.

Forum has over 50 retail stores throughout Europe and Kadgee has manufactured clothes for Forum since the early 1950's. The latest contract negotiations looked promising despite an expected price cut. Dieter Stutt, the Sales Director, felt that a price cut of 4% could be agreed. He had forecast that some of this lost operating profit could be recouped with cost savings that could be made in packaging and reduced material costs.

However, in the middle of April 2006, Forum's Managing Director decided that Forum would no longer be purchasing clothes from Kadgee from the end of May 2006. Following various high level negotiations, Forum has since agreed to extend the current sales contract though to the end of August 2006. After this date Forum will no longer purchase any clothing from Kadgee.

The loss of the Forum contract was announced to Kadgee employees during May 2006, before it was announced in the national press. Employees were naturally concerned about their jobs. Staff morale is low and the quality of the clothing currently being produced is lower than normal. It is expected that initially there will be 34 redundancies in September 2006, affecting three of Kadgee's factories as a result of the loss of this major customer. Further job cuts are likely later in 2006 at the three factories which have manufactured the range of clothing for Forum.

### **Changes in the supply chain**

Many of Kadgee's customers have needed to speed up the process of supplying clothing to their shops, so as to meet the demands of the market and to remain competitive. Kadgee has worked closely with its customers in order to achieve shorter lead times from design to delivery of finished products.

In 2001, Kadgee introduced a new design centre, centralised at its Head Office. The design centre uses computer aided design techniques, which has helped Kadgee's customers to appreciate the finished appearance of new designs. Andrin Burnak is confident that this has helped Kadgee to win new business and to retain its current customers.

It has also contributed to Kadgee's ability to speed up the process from design board to finished article. Kadgee has also benefited from working closer with its customers and this has resulted in additional orders, which Kadgee's customers' would otherwise have procured from overseas sources.

### **Growing competition from China**

During the 1990's and into the 21<sup>st</sup> century China has had a massive impact on the textile industry. China's manufacturing base is forecast to grow further and this will have a negative impact on many companies operating at a higher cost base elsewhere.

Many European companies have spent millions of Euros establishing manufacturing bases outside their home countries in the last 15 years. The companies which have set up operations in these low cost countries did so in an effort to cut costs by taking advantage of low overheads and lower labour rates, but still managed to maintain quality. However, even the companies that have moved some, or all, of their manufacturing bases and have taken steps to reduce their costs now have to reconsider their cost base again. This is because of the very low cost of Chinese imports, which they are having difficulty competing against.

Following the relaxation of trade barriers, there has recently been a deluge of Chinese clothing imports into Europe, the UK and the USA.

The quality of Chinese manufactured clothing is improving rapidly and it is now globally recognised that the "Made in China" label represents clothing of a higher quality than many European manufactured garments. Furthermore, the Chinese manufactured garments are being produced at a substantially lower manufacturing cost.

Kadgee has so far been operating in a market that has not been significantly affected by imported goods, as it produces medium to higher priced clothing, rather than cheaper ranges of clothes. However, many of Kadgee's customers are now looking to reduce their costs by either buying more imported clothes or by negotiating substantial price cuts from their existing suppliers. The purchasing power of European retailers being exerted on its suppliers is immense and Kadgee is under much pressure to deliver high quality goods at reduced operating profit margins from all of its customers.

**Round 1:**

Kadgee Fashion has hired your group as consultants. Based on the given information and scenario prepare a proposal for the Kadgee Board to review. The requirements are:

- 1) Long-term survival
- 2) Short term measures to cut costs
- 3) More financial success by undergoing transformational change