Fast Clothes

Benetton in the midst of a retail renaissance.

Janet Kersnar, CFO Europe Magazine

April 7, 2008

A scarf from the latest collection of upscale clothier Burberry and the cashmere-and-silk number — designed in its classic signature beige plaid — will set you back around €200. A scarf from high street fashion retailer Benetton — a multi-coloured wool creation in this season's bright hues — will cost you around €30. Which to choose? Ask a fashionista, and you might be in for a long debate. Ask Emilio Foà, and you won't wait long for an answer. A little over a year ago, he jumped at the chance to leave his deputy CFO job at Burberry's headquarters in London to become CFO of the €2 billion Italian business, which is 67% owned by the Benetton family. While the decision to move down the retail rail might raise a few eyebrows in the fashion world, Foà says the two companies have a lot more in common than people realise. Besides, it was a promotion that he couldn't refuse.

Yet Foà couldn't have joined Benetton at a trickier time. In an industry where it once reigned supreme, it has languished in recent years while rivals, such as Spain's Zara and Sweden's Hennes & Mauritz, have been rewriting the rules of the fast-fashion world, modernising supply chains and making new designs fly from drawing boards to shop floors in a matter of weeks. By the early 2000s, it was clear that Benetton was left "in a world of its own," says Frans Hoyer, an analyst at research house Proactive Independent Ideas (PI-Ideas). "It didn't really tap into trendiness, and that was obviously missing a trick."

Of more immediate concern for the new CFO, however, was that he arrived at Benetton's headquarters — a frescoed, 16th-century villa in Italy's north-eastern Treviso region — amid the fallout from the sudden resignations a few months earlier of the CEO and CFO, Silvano Cassano and Pier Francesco Facchini. Though largely given credit for masterminding a sorely needed turnaround programme that started in 2004, the two apparently fell out with Benetton family shareholders over the firm's international expansion strategy.

Picking up where the previous team left off, Foà and new CEO Gerolamo Caccia Dominioni are in a better position than many other turnaround teams — particularly because Benetton has a powerful, world-famous brand that's been working in its favour ever since it burst onto the fashion scene in the 1980s with brightly coloured knitwear and bold, socially conscious ad campaigns.

But many observers express amazement that the brand maintains so much power while the company falters, reporting generally flat sales between 2001 and 2006. "Benetton has been living on the glories of the past without big investments. It's just been pure maintenance, without any strategic plan," says Francesca Di Pasquantonio, an analyst at Deutsche Bank.

Recently promising investors annual average sales growth of at least 7% for the next decade, Foà insists that Benetton is putting its slacker days behind and undergoing "massive cultural change." For starters, it's ramping up the number of new fashion lines introduced each year from two to as many as 12 for each of its five brands. Meanwhile, the organisational structure is being simplified to increase accountability and visibility, while speeding up decision-making. There's also a much-needed capital investment programme — including €250m this year alone — to fuel expansion, bolster IT and supply-chain systems, and update shop decor.

What's in Store

The early signs of the turnaround are promising. Last month, Benetton announced 2007 results that included a 16% increase in net profit, to €145m, on a 9% increase in revenue, to €2 billion. Yet observers point out that this is only the beginning. "The task isn't about taking a factory and moving it from point A to point B," observes Hoyer of PI-Ideas. "It's about dealing with all the nitty-gritty complexities to revitalise the brand, all those important parts of the supply chain in between what they've become known for, the manufacturing at the back end and the advertising at the front end."

The new management team, led by Alessandro Benetton, appears well equipped for the long haul. The Harvard Business School-educated, private-equity executive was appointed vice chairman last year, taking over from his father and company co-founder, Luciano, who remains chairman. CEO Dominioni comes from Warner Music, with valuable experience of the "ups and downs," in Foà's words, of an industry with products facing extinction. Foà, meanwhile, joined the fashion industry nearly eight years ago, when he left a pharmaceuticals company to join Florence-based Gucci as group controller, working under CFO Robert Singer (currently CEO of pasta company Barilla and a non-executive director at Benetton). The job with Burberry came after that, in 2005.

Foà was both surprised and intrigued by the offer to move to Benetton. Though joining a firm whose financials were on a five-year slide wasn't to be taken lightly, he liked the idea of being "a fully fledged CFO" instead of a "number two," he says. He also appreciated the chance to join "one of the few good Italian companies" with an international

scope and a corporate-governance structure balancing family interests with external shareholders.

For its part, Benetton got a CFO who knows a lot more about supply chains than the average finance chief. "I'm not a supply-chain expert by any means," Foà insists. "But I do have the right level of knowledge to raise the right questions." For that he has Burberry to thank. In his early days at the £850m (€1.1 billion) fashion house, there wasn't anyone overseeing the global supply chain at headquarters, so the role landed with him by default.

He didn't mind. The area needed urgent attention — Burberry threatened to become a victim of its own success as it churned out more and more products every year without centralised direction. As Foà tells it, the company had grown into "a confederation of autonomous, successful entities, with lack of consistency from production to sourcing to financial processes to supply chains."

Critically, CFO Stacey Cartwright assigned him to the Atlas Project, a five-year, £50m IT and supply-chain transformation programme launched in 2005. The programme ran alongside another restructuring plan designed to "build in new group processes without sacrificing speed, the passion, the entrepreneurial spirit, and without becoming bureaucratic," as Foà describes it.

Chain Reaction

Little did he know then that those projects would be a good training ground for Benetton. Foà's work over the past 12 months has fallen into two categories: finessing the supply-chain work started by his predecessors; and supporting Alessandro Benetton in making sweeping changes to the way the company runs — that is, how decisions are made, targets set, performance assessed, capital allocated and so on.

On the supply chain, Foà rejects suggestions that Benetton is playing catch up with the fast-fashion pace-setters. "Everybody says, 'You're following what Zara did.' My view is that Benetton didn't do as Zara or H&M did," he asserts. "Benetton did — a bit later — what consumers around the world wanted: newness in store more often." (See "Rapid Response" at the end of this article.)

Foà says Benetton has spent the past three years greasing its supply chain, increasing the number of garments produced, from 110m in 2004 to more than 150m in 2007, and accelerating lead times, from more than six months to a few weeks for certain products. At the same time, the group has been reducing its reliance on manufacturers and suppliers in Italy, which accounts for around half of Benetton's sales, in favour of offshore facilities and outsourcers in low-cost countries such as Tunisia and Cambodia. (See "Supply and Demand" at the end of this article.) It's a move that Foà approaches with caution. "You definitely have benefits in terms of lower costs and being closer to markets, but by the same token you are buying higher risk — country risk and currency risk," he says. "And you are getting into a more complex and more costly flow of merchandise around the world."

And it's a move that makes Benetton more reliant than ever on the management of relationships up and down the supply chain. For suppliers, Foà is introducing a financing programme similar to that used at Burberry — "a win-win-win for them, for us and for the banks." Meanwhile, Benetton has been experimenting over the past year with a web-based tool that allows most of its stores to order basic merchandise around the clock for delivery within one week to shops in Italy and two weeks abroad.

While this could leave Benetton sitting on unnecessary buffer inventory, "last year our stock increased less than sales volume growth over the prior year, which means that we managed the whole thing properly," Foà says. What's more, "the quality [of the garments] has been the same, which is one of our key values, while sales and margins have increased, and working capital (with the exception of something technical on payables) was all under control."

The other component of Benetton's turnaround — reducing management layers and changing processes while increasing accountability — is more difficult to measure. But this, too, is an area where Benetton has a lot to learn from rivals. "If you look at H&M, its organisational structure is extremely light at the top, so local management are held to account," says PI-Ideas's Hoyer. "It's mind-boggling that it hasn't happened before [at Benetton]."

Better late than never. Foà says he and CEO Dominioni are spending a lot of time untangling an organisation that has grown too complex under a matrix-like structure. While they reduce management layers among regional and brand units, they've also been redefining who is in charge of which targets and giving them direct responsibility over P&Ls. These business heads now report to a single international director, with the exception of a handful of emerging markets with very high growth potential — China, India, Turkey, Latin America and Russia — which report directly to Dominioni.

Limited Levers

Foà expects the process redesign to soon bear fruit in one important area: capital allocation. During the annual budgeting process, for example, brand and market heads must now compete for a central budget, building business cases that fulfil a pre-agreed, group-wide set of criteria. "We are now much more rigorous and fact-based when it comes to capital allocation," he notes. "There's a healthy tension."

It's a lesson borne from painful memories. In the late 1990s, Benetton made an ill-judged foray into sportswear and sports equipment, leaving it with an array of businesses producing everything from tennis rackets (Prince) to ski boots (Nordica). After posting a net loss of €10m in 2002, the acquisitions went on the block the following year, selling for a

fraction of the price paid only a few years earlier.

Faced with today's economic downturn, fashion retailers are bracing themselves for a slump in consumer confidence, particularly in the US. But in a conference call with analysts in early March, Foà said that Benetton hadn't experienced a dramatic dip in sales since the credit crisis, largely because the Americas make up only around 2% of overall revenue. "For now, one of our strengths is that our commercial presence in the US is quite small, while about one-third of our cost of goods is dollar denominated, so we have a positive hedge," he says.

Nonetheless, like other CFOs, Foà is scouring the balance sheet to see where it can be shored up, just in case. It's no surprise that he's homed in on Benetton's property assets. In a break from the past, he says Benetton will now consider undertaking a sale-and-leaseback or other options to free up capital. Excluding "the most strategic locations" (that is, flagship stores in cities such as Milan, Paris, Tokyo and Moscow) "we can evaluate an opportunity to dispose of some locations if, where and when we see an opportunity to generate cash — value that can be invested somewhere else to boost commercial development," he says.

While that is a big step, it doesn't address something much greater that could hold Benetton back. Unlike its main retail rivals, the backbone of its business model are the franchisees which run most of its 5,000 shops and use Benetton as their wholesaler. Benetton owns only some 350 shops bearing its name, accounting for around one-fifth of revenue and only around 15% of Ebit last year. Though the model has its advantages — among other things, expansion is less costly and inventory risk is reduced — it's harder for the company to compete in fast fashion given the lead time needed for the franchisees to place their orders every time Benetton has a new collection. Furthermore, the franchise model hampers the company in terms of how far and how fast it can execute its turnaround, says Deutsche Bank's Di Pasquantonio. "The franchisees aren't under any obligation to do what the group says," she points out. Implementing the vast changes that the new CEO/CFO team envision "is going to be a very long process."

But in today's world of fast fashion — where collections can last mere weeks rather than entire seasons — time isn't on Benetton's side. In this industry, Foà says, "you can't take anything for granted." Including turnarounds.

Janet Kersnar is editor-in-chief at CFO Europe.

Rapid Response

Retailers such as Benetton were once happy selling just four collections a year — two for autumn/winter and two for spring/summer. But that was before Zara changed all the rules.

Starting in the 1990s, the company based in La Coruña, Spain began refreshing its collections throughout the year, giving consumers more choice, more often. It now sells some 500m garments a year. This requires near real-time sales data flowing from tills in hundreds of shops around the world to manufacturers, which make sure that orders are filled in less than 72 hours. And because Zara's clothes stay on the shelves for no longer than two weeks, the average customer drops into one of its stores 17 times a year, compared with three to four visits to competitor stores. It's what Richard Wilding, a professor at the Cranfield School of Management in the UK, calls a "when-it's-gone-it's-gone approach."

Zara is still speeding ahead, finessing and adapting its supply-chain model further. Last year, it launched a inventory-optimisation project, with the help of mathematicians at universities MIT and UCLA, and sponsored by Zara's CFO, Miguel Déaz. With the new analytical model, the aim is to reduce the guesswork of forecasting when stores need to place orders. The old system was largely based on manual input by shop managers, while the new software system automatically analyses historical data and seasonal trends to determine the best use of available stock. While still in the early stages of development, Zara reckons that the system has already boosted sales by 4% through a more customised mix of items at each shop, while leaving less unsold stock.

Zara isn't stopping there, says Jérémie Gallien, a professor at MIT who helped launch the project. He says CFO Déaz has asked them to start on another model to improve pricing decisions during clearance sales.

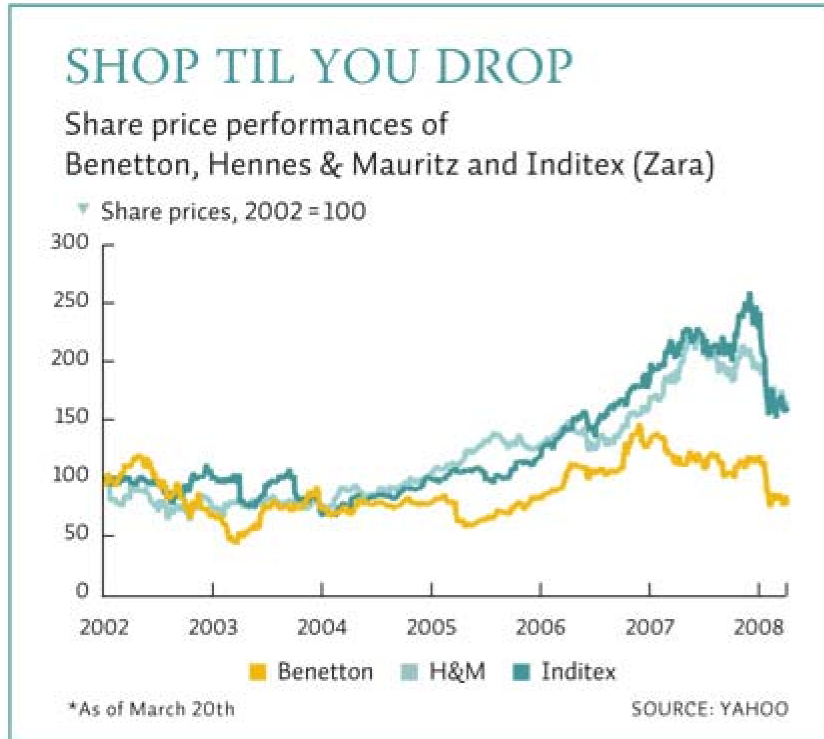
Rivals are watching with envy. In a new survey by AMR Research, 46% of clothing retailers said that their two main priorities for 2008 are improving analytical capabilities and increasing supply-chain visibility, up from 26% in 2007. But with more than 60% of respondents saying that they don't expect to increase IT budgets to help them do this, getting up to speed might be a lot easier said than done.

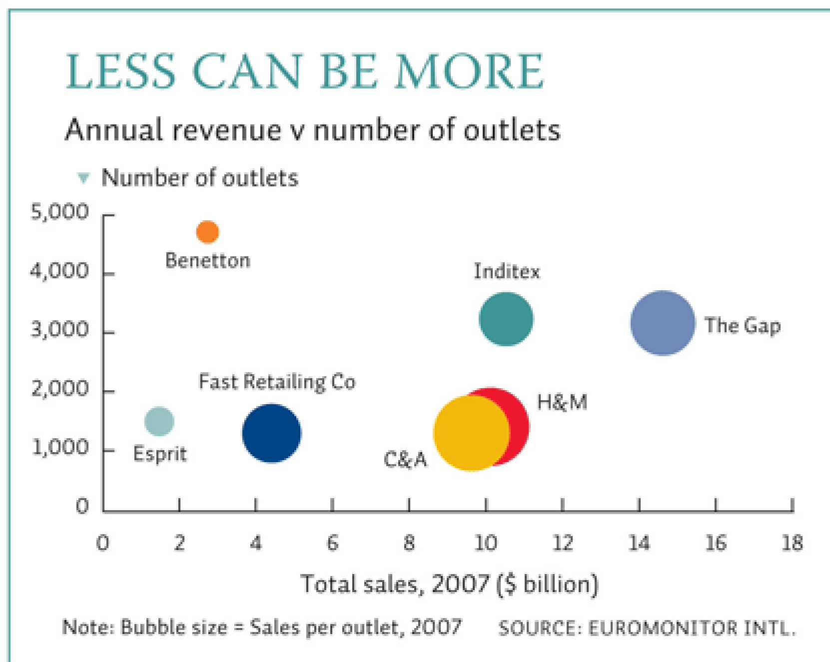
Fine-tuning Finance

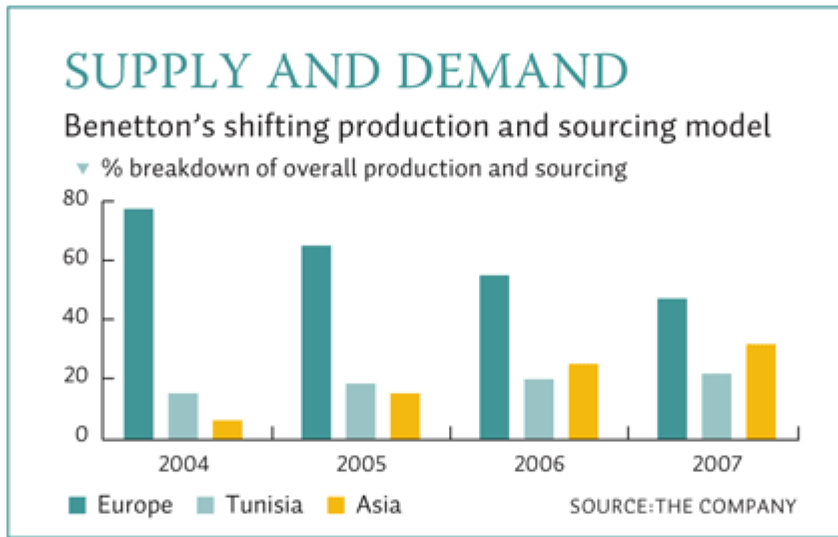
Emilio Foà isn't usually someone who looks a gift horse in the mouth. But while the finance team he inherited as Benetton's new CFO were "highly skilled, highly professional," he was struck by something as he leafed through a fat file on his desk one evening while preparing for his first board meeting: his new finance team were good at producing lots of data, not so good at producing information. What's more, a lot of the information — though arguably useful from an accounting perspective and for its efforts to become Sarbanes-Oxley compliant — wasn't what finance needed to help drive the company. "There was a level of sophistication in certain processes that was actually too high," he says. "So we were doing more than 100% of what was needed on some basic stuff, while missing parts of business

support," such as forecasting and analysis.

Foà's solution has been "a matter of shifting resources," while redesigning and streamlining about 20% of the processes that he felt were redundant. To some extent, he adds, the project has been helped by Benetton's decision a few months ago to delist from the New York Stock Exchange. Though Foà doesn't want to lose any of the benefits of being Sarbox compliant — such as greater process visibility — the delisting has freed up resources that can be redirected to other work aimed at producing better information. All told, he reckons he's better off than other CFOs — his team has both the skills and the tools, Foà says with relief, they just need to be "fine-tuned."







© CFO Publishing Corporation 2007. All rights reserved.