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## AAPN - Randy Harward Miami Speech Transcript

As you can see from my leading slide here, I have worked through my career building Sustainability, Innovation, and Leadership in the industry, and yet, here I am talking to you today about retailing and the importance of turns. And I have to tell you that for virtually my entire career, which is now north of 45 years in the industry, I keep getting stuck having to talk about this topic. It seems to be an unlock that's necessary in order for companies to have the latitude and the freedom to work on these other things. I end up, first, having to go back to discuss just what is retail. If you were to look at an optimism gauge here three years ago, versus this year, this group's really optimistic right now. There's a lot of opportunity. But from a retailer side, realizing I speak mostly as someone who's been on the retail side, I don't really see retailers understanding retail and what it is they actually are doing. And so, although I'm going to speak from a retailer's perspective and many of you are on the supply side, you need to understand what I am going to tell you as well as they do, because you are part of their solution. You're all in one boat.

I am going to do this by telling three stories. I apologize to some of you who have heard me give this talk before, and this is going to be a little bit compressed due to time constraints. Mike has the longer version I think on the AAPN website and a yet longer fire side chat on the topic. If you're really interested in the topic, go there. Maybe we can have some good questions and discussion at the end if we have time.

**The first story:** Five or six years into my career I got into the outdoor retailer business. I was a minor partner in a small group of specialty outdoor stores in the San Francisco Bay area. When I moved into this role, I was all excited to get started and the two current owners put the books on the table and said "Hey, the best thing you can do for us right now is to balance the books, they haven't been done in three years."

So I bought one of the first 100 IBM PCs, I put Peach Tree accounting software on it, which didn't work very well, and taught ourselves accounting enough to sit down with the bank who was very motivated to help us, because as it turned out we were in trouble and the bank was scared we would not repay credit lines. As we balanced the books forward it just got worse and worse and worse. All my staff friends were thinking, oh Randy is in charge now and we're going to get raises, everything's going to be great. And I was thinking, I'm going to have to close stores and do layoffs because we were about 2 million in debt, in a store that only did about 2 million in annual sales. We only had about 400,000 in really random inventory. That's not a good situation if you're a retailer. So I called everyone together from our three stores, about 60 people total, opened the books and let them know where we were. I started by saying, we're going to have to figure out how we're going to shut this thing down and close, maybe we can keep one store for a while, but there's no way we can survive. They didn't like that story, of course, and wanted to stay open. They wanted to try to figure it out. I said, well, first things first, we don't have any working cash, so you all will have to take pay cut. And so they all took a 25% voluntarily pay cut. I said, the only thing we can do is turn the inventory we have. The best you can turn inventory the longer we can survive. I didn't ever think we were going to come out of it. So I assigned each person in the store to be buyers and sales managers for each little corner of each store, and told them we're going to need a minimum eight or nine turns of all that inventory before we're out of debt. Well, what happened was a miracle. Those people ended up doing about 11 turns for the whole store. Some areas turned 23 times in 11 months. We were cash happy and out of debt. And people who were earning \$6 previously, were earning between \$11 and \$17 an hour, all within the same year.

So how did we do that? I couldn't get anybody to ship to us. We were in debt and we weren't paying bills. So I called up all our suppliers and asked, how about if you use that new service called FedEx (this was in the late seventies, early eighties), and you ship us, COD. We'll pay the shipping and you can charge us and extra 15% for every item you send us. If we go out of business you're not going to get anything, so this is better than that. Every single supplier said, okay, that sounds good. How can they go wrong? So, look at this weird solution. Here we are, in deep debt, and we lowered margins to 25% as the solution, the only one we had. We always thought that this was going to be a handicap, but it turned out to be the saving grace of that organization. I have never forgotten that lesson, because those turns at 20 to 25% margins generated so much cash and allowed us to move inventory and to be so fleet of foot that I've never forgotten it. It was an epiphany. I was lucky to have that experience early in my career.

Looking at "retailing" slide: This is what we do in our industry. We take customer needs and desires, we make stuff, and yes, it requires cash and design input and materials and skill and technology. We make inventory. We tend to get really fixated on the cost of that inventory though. Then we sell it, and after discounts we get back a little bit of profit. This is what we do. What I learned at this little group of stores is that **it is all about turns**, not about focusing on inventory cost. So the first lesson, that cycle has to be the focus of everybody in the organization.

**Second of my three stories:** As I moved through my career, at Patagonia I worked in quality management, and I ran R&D and Advanced Development there. I moved to Under Armor for the last eight years and ran advanced development and Material Innovation. In each of those positions, again, back to my opening comment, I got stuck, not with that work at hand, but in getting people to understand that the retail turn cycle had to be the focus. So if I would have a material developer, and Lex can attest to this, bring me a solution and it was really great technically, but it wasn't actually helping the company do better overall. I would send them back to the drawing board. I had to constantly get people to focus on the whole problem. As Barbara pointed out earlier, people focused only on their part. I kept running into this over and over and over again.

There are other lessons that came out of this work. One is that you have to own something in order to be able to leverage it. Retailers these days seem to not to want to own anything, they don't want to own inventory. They don't want make commitments. Nobody wants to project yarn. No one wants to make capacity or finance guarantees, you name it. Nobody wants to own anything in business these days. And the truth is, owning something is the best thing you can have, especially if it's early in the process, because you can leverage it. So if you own one side of the equation, use it to set up the other side of the equation. And that might be inventory or capacity positions, or getting invested in new approaches like what Carlos and Kurt were talking about. Those are ownership positions. If you buy into that process and make it part of your strategy, use that strategy.

Another lesson was, Sourcing and Finance gotta wanna. I borrow "gotta wanna" from a good friend. If you ever want to read a really good book on business, read **Jack Stack's** book "**The Great Game of Business**", I think it's one of the great business books ever written. Sourcing and Finance have to understand that material and capacity positioning, aligned with design and manufacturing constraints, and informed by consumption data, is way more important than managing house margin. I'll talk a little bit later about some tools that I've used to try and make that easier.

Next lesson? I think governments have to incentivize and finance capability as much as sales. Generally government incentivize bank policy, and banks get a lot of help, as long as they're helping to finance business sales growth. But that business growth and the

instruments involved are mainly around financing against PO's. There's not a lot of incentive for them to help a factory set up capacity based on commitments. There are few financial commitment tools out there and governments need to focus on this. That is a conversation you should have with Government officials and retail brands. You have to do this.

Next lesson? Retailers own the cash and designs and decisions, and they need to use this leverage to optimize the whole process, not just to push for lower cost. So there's a lot here, but in general, like Barbara said, the main thing you have to do is learn to own the whole problem. You don't own just your part of it. This is specifically talking about retailers, but it applies to the supply side as well.

**There are some main takeaways.** One is that you have to really love constraints. I gave a talk a couple years ago to students in New York, and I was saying similar things like "a designer has to understand the whole". If you're working on a collection, understand the factory, understand all the components of it, you need to own the whole problem. And at the end, there was a little panel like this, and a student got up and said, "I have to argue with you on that comment. I don't think as a designer, I should have to care about all those things, because it's going to limit my creativity". Many of you have heard this. I came up with the smartest answer I've ever come up with right off the cuff. I said, gosh, I think you have to be careful about what you're suggesting. And he said, what's that? I said, you're suggesting that knowledge is limiting. He said, no, I didn't say that. I said, yes, you did. The best designers I've ever met are the ones who actually understand everything. They create really practical products that really resonate. And they're makeable and fit elegantly into the manufacturing and consumer marketplace. You have to love constraints. When I said that all the professors stood and clapped, which was a lot of fun.

There are lots of examples of how constraints drive innovation and solutions. Baltimore, where I was working at Under Armor, is a medical hub with 63 hospitals in the area. During the early days of the COVID outbreak, the federal government had to take all Baltimore's masks and PPE and ship it up to New York. The local hospitals freaked out and called us with a need for a million units "tomorrow". We could not set up a sewing factory that fast, but at our lighthouse facility we had a Lectra cutter, full size, not a sample cutter. And we knew we could cut 50 or 100 plies. And so I challenged our design team at Lighthouse to design a mask that requires only cutting, no sewing or assembly. Within 12 hours we had several versions. And within one day we had something we called the Origami Mask, which is just a flat pattern that the user folds and tucks into a two layer mask, and it worked really well. By the end of that week we had made 600,000 units and we made 15 million of those masks for Baltimore hospitals, all before anybody could get in all the manufactured masks that they had ordered. The constraint of having no other option created a really great solution.

More examples. When I joined UA in 2014, the company was about \$1.5B, and when I left they were about \$5B. The company now has 80% fewer materials and 60% fewer colors at \$5B than it had \$1.5B. And I would say the company couldn't have gone to that size without having done that. I think they have a more focused point of view. It's much clearer. It's actually easier for customers to understand what they're selling. There was a lot of creativity that came out of that.

**Mike likes the story of a new fabric** that we developed that didn't have the kind of gooeey four way stretch that women's tights typically have. It had a much more unbalanced stretch, which I thought created a better fit. But it was different, it fit a bit different, it cut different and nobody wanted to use it. So we set up a program where we would let a group of designers bring a product to market quickly, manufacturing it right there in Baltimore, 2,000 to 4,000 units at a time. They could have a new collection come out every month. They loved the idea of having feedback on their designs without waiting 18 months for the

whole sales cycle, so they all signed up, raised their hands right away. Those programs were highly successful. That ended up being a huge introduction of that material. This fabric became about 40% of all the stretch tight fabric volume in the Under Armour line. So again, constraint driving creativity.

There's so many examples of this. Patagonia increased sales of base layers 25% just by taking material positions and sticking to those material positions with suppliers, just like you guys all work on every day.

**Guess?**, look at Guess?. They became a multibillion dollar company on three colors.

**American Apparel**, you know, got into the billions on two fabric constructions, both jerseys, one lighter, one a little heavier. They were well over a billion before they started branching out into lot of fabrics.

So while I hear about the concern about not having enough materials in this region. And while I stood on this stage in years past and I would say material availability is a problem. I agree. It still is. But I think we are not in the same situation anymore. There's a lot that has changed, you guys have built up the region. It's not perfect yet, we don't have all the materials we need, but we are in a much better position, and in a model where people are really trying to work within constraints, there's a lot of opportunity in the region.

So these are the **two main things** I hope you hear from me today. **Love constraints**. And this idea that the three of us have talked about, and the theme that has been coming up throughout this weekend, that cost reduction ends up being the smallest profit driver. Turns and velocity, and responding to market, and not having markdowns, those things are much more important. Nothing you don't know, but it turns out to be extraordinarily difficult to unblock this problem. A lot of it is simply because it's now systemic, partly because the race to far off low cost labor happened at the same time as the development of computer software, so our way of working is now systemic. We gave up flexibility, and like Barbara described we gave up a lot in that process to get those lower prices. A lot of us made a lot of money out of that effort, but it is not the only way, and increasingly not the best way today. All of the software in ERP systems, banking systems, the way that we pay factories, everything is literally built on that model and it has to be taken apart. So it's not just in our heads, it's a systemic problem.

So I started coming up with models that I could use to sit down with finance people. I'm sure it's the real thing you want to hear from me today is about this tool, not all the other stuff I'm talking about, and I'll make it available to you. These little gray areas in here are cells you can change, so you can modify it to meet your company's situation or to describe an opportunity that you think exists. It's made up of, of several sections, let me go through it real quick.

**Left Column:** Typically we have long lead time manufacturing. It creates high inventories, large discounts, and relatively low turns per year. In fact that 2.7 turns per year may be optimistic to be honest. Most big retailers are really struggling to get that 0.7, it's just not working out very well, with low turns and all the discounts you can see the average earned margin it's pretty low. And it yields only \$2.70 for every dollar inventory that you put in.

**Middle Column:** The second scenario is manufacturing in regions. So I tell retailers large and small, even if you don't change anything, even if you don't change your system, the way you buy, or the way you position goods, all of your merchandising, okay, just leave 'em alone, but at least move some of it in the region so that you have an opportunity, maybe, to

get to four turns. You'll earn a higher margin because you have less inventory risk, and you end up earning maybe \$4 for every dollar of inventory.

**Right Column:** And then there's this third model. Certainly Carlos and Kurt were talking about it yesterday, but I'm also saying beyond that you can design a speed to market model. Build collections that require a company take **on more more commitments, not less**. Retailers want even less commitments and think it will bring them speed. They want to be able to do anything at any time. They have to be retrained to say, actually, if you want speed to market, you need to be more constrained. Design into manufacturing in the region, using multi calendars, positioned materials, color palettes, and manufacturing capabilities and capacity for higher turns and market relevance.

So if we look the top scenario, it's the lowest gross margin earned. It's the highest inventory and it's the lowest gross margin per dollar inventory. That's the predominant business that people are in today. I tell companies to do this (middle row scenario) in the short term, simply move from a hundred percent work like that. And move some of it in region, say 20%, and for a smaller portion, I don't care if it's 3% or 5% or 10%, but just start on a close to market constrained position for speed, and you will find some pretty huge advantages. This is a place in the conversation where most CFOs stop pushing back and want to look at my formulas. They do not understand how moving 10% of manufacturing can get a 7% high gross margin dollars with 10% less inventory and 18% higher earnings on every inventory dollar. But this is basic retail math.

It is important for leaders to realize that focusing on 100 basis point goals is peanuts when you have 18% or 10% or 7% on the table, this is a huge opportunity for companies. And does that look that difficult? The truth is, for all of you, if a retailer came to you and said they wanted to move 10% into a constrained position, high speed model, that's actually easier than the 20% managed in the normal way, isn't it? With experience the truth of this is that the easiest stuff to do this way are likely your big programs that are core, where you actually know the volume and the velocity. It's actually the easiest stuff to do. So what I'm encouraging and talking to all retailers about is to start, learn with 3% or 5% or 10%. Use it to understand the systems changes that you need in order to use this approach more broadly, (bottom row scenario) where you move maybe 60% into an astronomically better position. If you're a retailer, look at that number, 24% higher Gross Margin margin dollars, 38%, less inventory, 70% higher gross margin dollars earned per dollar of inventory. Does this look crazy or rational to you?

To the average retailer. This is crazy and they don't understand it. So when I asked Kurt yesterday, do retailers look at what they're doing as cute, not really a serious model, it's because they don't understand actually where it could reshape their businesses. You have to understand this model, this tool, and talk to every person you work with from a buyer all the way up to top leaders. Get them to understand this. It's a really important conversation because focusing on marginal cost reductions is not going to get them where they want to go. I know I'm not telling you anything you don't already know.

**I said I had three stories.** Early in my career at Patagonia, I was in charge of setting up their quality systems. I'm very proud of the quality reputation that Patagonia has, it was quite a journey. When I took the job I knew nothing about quality and it took lot of time to figure out the right approach. During that time, this was in early nineties, I bumped into W Edwards Deming. My timing was good as he had recently been rediscovered in the U.S. and I ended up spending a lot of time with him. He is the father of what we now call modern quality management, I consider him a mentor.

After WWII MacArthur sent Deming and others to Japan and Germany to help them rebuild manufacturing after war. MacArthur was impressed with the way Deming had helped improve the quality of munitions during the war using unskilled labor. They found willing students in Japan and in Germany and started the quality revolution that we now know in automotive and electronics in those countries. To this day, the greatest prize you can receive in Japan, as a manufacturer, is the Deming Prize. But I was an environmentalist, and his approach, that everything is virtually limitless, that these are just system problems, concerned me. Mankind can't keep growing forever. I thought there has to be a limit to what mankind can do to the earth. So I would argue with him, and one day at lunch, he said, Mr. Harward, okay, okay, I think you're wrong, you're not looking at it correctly, but I can see that you have your life's work cut out for you. I had no idea then that he was right. That's the kind of work that I've been working on forever. Trying to get people to understand the whole, including the environment. And what I've been talking about with that little retailing diagram, and my spreadsheet, is really just one part of it. I now understand that he was actually encouraging me to own the whole problem, to expand my frame.

Don't be afraid of including the entire environmental frame in your problem set. This is what we now call sustainability and circularity. Accept the constraints of that frame, really be fearless about it. The solutions it will create, the most elegant and successful matches to what society wants, what global mega trends are moving toward will go to those that optimize that entire picture. Don't be afraid of including it as part of your systems problem. Increasingly it's going to be the most successful solution.