Supply Chain Strategies in the Apparel Industry: The Case of Victoria's Secret

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Abstract

This research provides an overview of the underlying dynamics, drivers, top players, supply chain structure and challenges facing the apparel industry. We present the case of Limited Brands Inc. and describe the positioning of the company within the apparel industry. We then address business processes critical to the success of the Victoria's Secret Business Unit of Limited Brands. This research draws extensively on interviews with company officials at Limited Brands that provided rich insight into a wide range of supply chain practices specific to the Victoria's Secret business. The success of Victoria's Secret can be attributed to a set of important supply chain activities, driven primarily by a collaborative intra-company effort. Insights gained from this research can also be leveraged to understand other industries such as consumer packaged goods, computers, and electronics industries which face similar supply chain issues.

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1 Introduction

This research addresses today's supply chains specific to the apparel industry in the US. Within the apparel industry, we focus on apparel companies selling products to the consumers vis-à-vis selling to retailers in the United States. We identify the fundamental corporate strategies, operating models, and best supply chain processes important to maintaining a competitive position in today's apparel supply chains.

This study is part of the MIT Supply Chain 2020 Project (SC2020). The objective of the SC2020 project is to identify and analyze the factors that are critical to the success of future supply chains up to the year 2020. Phase I of this industry-wide research initiative involves nine different industries and twenty-one different case studies within these industries. The nine industries are: Aerospace, Apparel/Footwear, Automotive, Computers, Communication Equipment, Consumer Package Goods, Pharmaceutical, Petroleum and Retail.

This research is divided into three parts. The first part studies the overall apparel industry supply chain, from apparel manufacturing and sourcing to apparel retail and distribution. We present various supply chain challenges and opportunities within these individual silos of activity. We also present relevant financial information including historical revenues and operating margins as well as key industry trends and drivers. The second part involves a case study of Limited Brands (see chapter 4). We discuss the positioning of this company within the apparel industry. We provide a brief background on Limited Brands and discuss the individual business units within the company and their product and service offerings. We discuss the competitive landscape in which its various businesses operate and view the company from a strategic as well as operational perspective. The third part of the research investigates the specific supply chain of Limited Brands' Victoria's Secret business (see chapter 5). This research identifies Victoria's Secret's business strategy, operating model, operational objectives and various supply chain practices required to make its supply chain competitive and excellent. Figure 1 describes the SC2020 project's framework of an "excellent" supply chains.

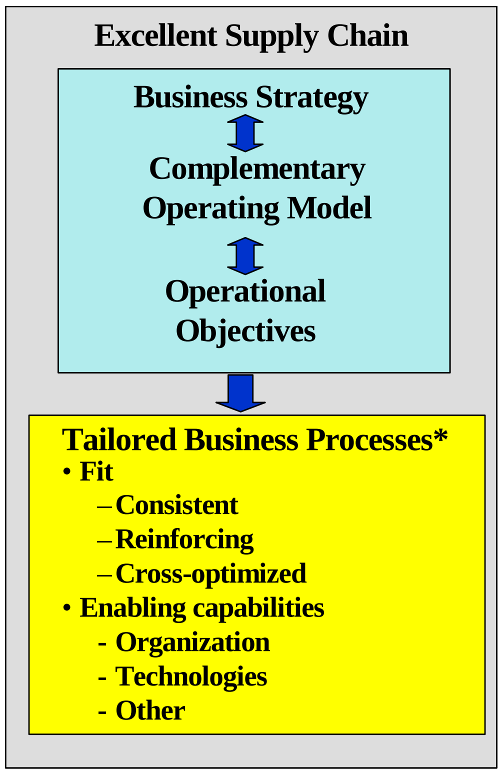


Figure 1 Framework For Supply Chain Excellence
Source: SC 2020 Project

The above framework implies that for a business to have an excellent supply chain, it has to mark clearly defined operational objectives, which should be part of an operating model that is well aligned with the overall corporate strategy. This research identifies specific processes that are tailored to the Victoria's Secret's business and attempts to understand how these processes tie to the corporate strategy and operating model, how they fit together, reinforce each other, and are cross optimized, and finally how they are enabled.

We analyze the Victoria's Secret's supply chain by dividing it into three functional areas: supply-side business processes, inside business processes and customer-side business processes. Within the supply-side processes, the key areas discussed are collaborative product design, manufacturing, sourcing, supplier management and segmentation. Within inside processes, the important topics covered are inventory management, warehousing, transportation and logistics management. Last, within the customer-side processes, the key areas include customer segmentation, multi-channel retail management, demand planning, forecasting and allocation, order fulfillment and customer service.

1.1 Motivation

As will be discussed in chapter three, the apparel industry faces various supply chain challenges, many due to the fact that the major part of apparel manufacturing activity for the United States market has moved outside the country to low-labor-cost countries in the Far-East. Thus, due to long physical distances, apparel companies in the US are continuously challenged to quickly respond to changing trends, to reduce long lead-times, to execute collaborative product development with suppliers using effective communication and to ensure total supply chain visibility. Moreover, fickle consumer preferences and shortening of the product life cycles make the apparel industry very challenging from a supply chain perspective. Insights gained from this research can be also be leveraged to understand other industries like consumer packaged goods, computers and electronics industries, which face similar supply chain issues.

The Victoria's Secret business provides a case study representative of most supply chain challenges faced by the apparel industry as a whole. Victoria's Secret is a multi-channel retailer selling its products through physical stores located throughout the United States, as well as through a collection of printed catalogs and an online shop. Its major product offerings lie in the category of intimate apparel, sleepwear, apparel, shoes and accessories and swimwear. For the purpose of this research, we focus on the intimate apparel segment of Victoria's Secret. Intimate apparel represents the largest portion of Victoria's Secret business and is sold through all the retail channels described above.

1.2 Methodology

This research has been executed in three different steps. The first step involved thorough research on the apparel industry as a whole, with the help of articles from *American Apparel and Footwear Association, Harvard Business Review*, newspapers like *Women's Wear Daily, Daily News Record, Journal of retail and Distribution, Wall Street Journal* and magazines like *Apparel*. Additionally, one-on-one telephone interviews conducted with industry experts provided a tremendous resource. These industry experts came from 3rd party logistics, apparel and footwear software solutions and supply chain consulting fields.

The second step, which involved understanding the positioning of Limited Brands within the apparel industry, was primarily researched using available online public information, the company website, and visits to a company speaker event.

The third step, which dealt specifically with the Victoria's Secret supply chain, was researched primarily by one-on-one interviews with company officials, both telephonically as well as from a site visit of the Limited Brands headquarters in Columbus, Ohio, with supporting information from public sources. These interviews involved extensive meetings with relevant personnel in charge of crucial functions within the Victoria's Secret supply chain. The departments interviewed include: Limited Logistics Services, Mast Industries, Demand Planning and Merchandise Allocation, Victoria's Secret Stores and Victoria's Secret Direct. The people interviewed hold positions ranging from Directorial level up to the President level.

Finally, and as a result of the above research, top operational Key Performance Indicators (KPI) for tracking the performance of Victoria's Secret Supply Chain are listed along with their practical application relative to the brand. To conclude, these KPIs have been fitted into a balancing framework and their importance relative to each other is identified.

2 Literature Review

The literature is divided in 3 parts:

- Literature on the global apparel value chain with a focus on global sourcing, evolving supplier-buyer relationships and elements of collaboration in the area of product design.
- Literature on corporate strategy and supply chain strategy from an apparel company's standpoint.
- Literature on multi-channel retailing. This is relevant to the Limited Brands' distribution strategy, and, more specifically that of Victoria's Secret.

In the 1990s, Gereffi et al developed a framework called "global commodity chains" (Gereffi, 1994, 1999) also called "global value chain" (Gereffi and Memedovic, 2003), that tie the concept of the value-added chain directly to the global organization of industries (Gereffi and Korzeniewicz, 1994). In this article, the value chain is defined as the range of activities involved in the design, production and marketing of a product. Gereffi et al's work highlights the growing importance of new global buyers (primarily retailers and brand marketers) as key drivers in the formation of globally dispersed and organizationally fragmented production and distribution networks and also highlights the importance of coordination across firm boundaries.

(Gereffi et al, forthcoming) have built a theoretical framework to help explain governance patterns in global value chains. They state that the expansion and growing capabilities of the global supply-base of the apparel industry have permitted it to move rapidly from captive to more complex relational value chains over the span of just a few decades. “Captive value chain” is defined as one in which suppliers are frequently confined to a narrow range of tasks, for example, mainly engaged in simple assembly. This was the scenario when supplier competence was low and the ability to provide detailed instructions on part of the lead firm, as well as product specifications and complexity were both relatively high, requiring a great deal of intervention and control on the part of the lead firm. On the other hand, the “relational value chain” comes into play when product specifications cannot be codified, transactions are complex and supplier competence is high. In this case, there is a strong motivation for lead firms to outsource and this requires effective sharing of information between buyers and sellers.

Building on the idea of collaboration in the apparel supply chain, Johnson (2002) writes about the importance of collaboration in producing a steady stream of innovative products particularly for short-life products, like apparel or computers. Johnson states that supply chain relationships entirely focused on extracting cost reductions from suppliers in low cost countries is unsustainable. As physical distances between the various players of the apparel supply chain have increased, due to globalization of production, so has supply chain complexity. Thus, companies in the apparel industry must find new ways to leverage their supply chain partnerships through information integration and collaboration – improving products, driving down cycle times, and reducing supply chain costs. Johnson examines how players throughout the apparel supply chain, starting from raw fiber producers to retail stores, are reinventing their businesses through web-centric collaborative product management to ensure better management of the increasing supply chain complexity.

The next category of relevant literature is focused on corporate and supply chain strategy. This literature helps in analyzing the Limited Brands' position within the Apparel Industry, and more specifically, Victoria's Secret's supply chain from a strategic, as well as operational, standpoint.

Porter (1996) defines strategy as creating fit among a company's activities. He states that while operational effectiveness is a necessary tool, a clear overarching company strategy is the answer to long-term sustainability. He states that strategic positioning is a key activity for strategy. Extrapolating this to the case of Limited Brands (see chapter four), in the mid-90s, the company did not seem to have a clear cut strategy. With about fourteen different brands under its umbrella, catering to a variety of different demographics, there appears to have been an attempt to be "everything to everyone". Limited's growth slowed dramatically and performance was erratic, as competitors like The Gap swiped market share (Merrick, 2005). Evidently, the company was losing its focus and appeal. As a result, top management had to look into reinventing the company's strategic positioning in the market and to concentrate on key competencies.

Schlesinger et al (1997), point out two important missing elements in the concept of strategy that Porter (1996) presented in his article, "What Is Strategy?". These are people (both customers and employees) and organization. They claim that until Porter's concepts encompass all the elements of what they term an operating strategy (policies, processes, controls, practices, organization, and culture) and a service delivery system (routes, equipment, information systems, locations), they will fall short of their full potential.

Fisher (1997) presents a framework to help companies devise a supply chain strategy based on the nature of the demand for their products. Fisher divides products into functional and innovative. He describes functional products as having relatively longer product-life cycles and stable demand pattern, requiring an efficient supply chain, and innovative products as having short life-cycles and unpredictable demand, thus requiring a responsive supply chain. This framework is useful in thinking about the Victoria’s Secret supply chain (see chapter 5, 6), as about 60% of their products are basics and 40% are fashion items. An example of basic lingerie would be a beige, white or black bra, and an example of an innovative product would be the IPEX® bra, which is advertised as “the world’s most advanced bra” (see chapter 4). There are distinct differences between the demand patterns of the two. For example, the IPEX® generated 300 online orders in the first hour of its launch, a number that is very hard to predict.

At this point, it is necessary to introduce and discuss the well known case of supply chain responsiveness within the apparel industry, Zara. Zara is a Spanish fashion retailer with about 650 stores in about 50 countries. With an extremely responsive supply chain and high profit margins relative to the industry average, Zara is the envy of the apparel industry. Ferdows et al (2004) speculate that the deepest secret of Zara's success might lie in its ability to sustain an environment that optimizes the entire supply chain rather than each step. He states that Zara's senior managers seem to intuitively comprehend the nonlinear relationship between capacity utilization, demand variability, and responsiveness. He explains that this relationship is well demonstrated by "queuing theory", which explains that as capacity utilization begins to increase from low levels, waiting times increase gradually.

In contrast, Limited Brands is a retailer which focuses on fashion as well as basic items. With majority of its products in the basic category, it appears that there is no sense of urgency to create a “super-responsive” supply chain for basic products. On the other hand, we discuss in chapters 4, 5 and 6 how Victoria’s Secret’s supply chain is geared toward responsiveness in the case of its fashion goods.

Finally, we turn to the literature on multi-channel retailing. As Victoria's Secret is a multi-channel retailer, it is helpful to review what has been written on this type of selling strategy. Although there is little specifically on the apparel industry, there are two important readings on the subject: Berman and Thelen (2004) have written a guide to developing and managing a well-integrated multi-channel retail strategy. The authors state that "a well-integrated multi-channel format enables consumers to examine goods at one channel, buy them at another channel, and finally pick them up at a third channel." Victoria's Secret Stores are not yet integrated with its direct business. The question of whether this interferes with customer satisfaction is examined in chapter 5. Lightfoot (2003) presents a case study on Egghead Software, Inc., a successful software and hardware multi-channel retailer in the United States until the mid-1990s, that closed down its retails operations and became an ecommerce only retailer in 1998. This later turned out to be a fatal decision for Egghead, and as a result the company went bankrupt. In contrast, Victoria's Secret leverages its multi-channel approach to the market through its profitable and sizable retail store operations as well as a rapidly growing direct business.

3 The Apparel Industry

The chapter provides an overview of the apparel industry, covering financial conditions, customer segments, sales channels, supply chain structure, industry trends and drivers and supply chain challenges.

The government based Standard Industrial Classification (SIC) Major Group 23 defined as “Apparel and Other Finished Products Made from Fabrics and Similar Materials” represents all the categories of products in the apparel industry for the purpose of this study (Hoover’s Online).

3.1 Industry Overview

The United States is one of the world’s largest markets for apparel products. In 2003, U.S. consumption of apparel and footwear amounted to more than $311 billion (Rees & Hathcote, 2004). The United States apparel retail market grew by 1.5% in 2003 to reach a value of $212.5 billion. The retail market compounded at a slow annual growth rate (CAGR) of 0.8% between 1999 and 2003 ("Datamonitor Market Research," 2004). Most of this growth came from specialty apparel retail - establishments primarily engaged in selling a specialized line of ready-to-wear apparel and accessories like hosiery, underwear, skirts, dresses etc, to a target customer segment. Figure 2 shows the performance of specialty apparel stores in comparison to other retail channels.

Figure 2 Source: Standard &Poor's Apparel and Footwear Industry Survey 2004

The apparel industry is characterized by slow growth, overcapacity and low-priced imports, and competes primarily on cost. It has historically been a labor intensive, low technology industry in which not many capital investments in technology or process innovation have taken place.

By late 1980s, the U.S. textile and apparel industry, like many other industries, had lost ground to foreign-made goods as price pressures drove many of the large retailers to explore new and alternate sourcing methods to remain competitive in the deflationary apparel market. The shift was primarily driven by low labor rates in countries in the Pacific Rim and Caribbean Basin, Eastern Europe and East Asia. As barriers to entry in the area of manufacturing were low, this resulted in a large number of fragmented manufacturers and sub-contractors. From 1974 to 1985, the share of the U.S apparel market held by imported goods more than doubled. In 1985, total consumer retail expenditures for apparel were estimated at $127 billion and 44% of this expenditure came from imports. At this point, the growing trade imbalance in clothing and textiles represented 12% of the total U.S trade deficit in 1986 (Hammond & Kelly, 1990).

At the same time, there was an increasing trend toward "private label" apparel designed and labeled by retailers and produced by lower cost apparel subcontractors. The concept of private label apparel allowed retailers to bypass costly domestic designers and branded apparel manufacturers. Private label apparel was offered relatively cheaper than branded apparel, making it more affordable for the common masses. This aided the trend of mass marketing of apparel and was led by large retailers like Wal-Mart, J.C. Penny and Sears.

However, after a decade or more years of commoditization of clothing, a marked increase of differentiated fashion recently appeared in the year 2003 (Standard and Poor's, 2004). This ignited consumer interest, and both men and women returned to the mall in search of the latest silhouettes. As discussed in chapters 4 and 5, we find that this trend toward differentiated fashion is an important enabler of growth and creation of brand identity for brands like Victoria's Secret.

3.2 Consumer Segments

In 2003, total US apparel sales were $166 billion, down 5.1% from $175 billion in 2002, according to the NPD Group. Women's apparel sales fell 7.1% to $90.1 billion and men's apparel sales fell 6.4% to $46.9 billion in comparison with 2002. The womenswear category accounted for just over 52% and menswear accounted for 28% of the year's sales in 2003 (Standard and Poor's, 2004).

Today, most apparel companies segment their customer by demographics. For example, Generation Y — the 75 million people born between 1977 and 1994, a cohort comprising 25% of the US population - spends or influences the spending of approximately $200 billion a year (Standard and Poor's, 2004). This group is also influential in setting trends that influence future product design for the slightly older Generation X (people born between 1965 and 1976). Many small specialty retailers and apparel companies — such as Quiksilver Inc., Abercrombie & Fitch Co., American Eagle Outfitters Inc., Pacific Sunwear of California Inc., and Urban Outfitters Inc. and large apparel companies such as Victoria's Secret (see Chapter 5), Jones Apparel Group, Tommy Hilfiger, and Polo Ralph Lauren have recently either acquired or developed products in an effort to tap into Generation Y's psyche.

3.3 Sales Channels

Today, most companies distribute their products through a variety of channels, such as wholesale, catalog, and Internet, as well as through their own retail stores. Within the wholesale channel, manufacturers often try to sell to various types of retailers, including department stores, specialty stores, discount stores, and national chains. For retailers, expanding the number of stores is a way to diversify risk, while also leveraging efficiencies across a greater number of stores and products. While many apparel retailers had a tough time in 2002 and 2003, they continued to expand both domestically and internationally. Victoria's Secret Stores (see Chapter 5), an exception, has trimmed down its number of stores from 1014 in the year 2002 to 1001 stores in the year 2004. This decrease can attributed to a higher-level company decision to strategically focus its efforts on stores above certain cut-off levels of sales per square foot.

To provide a lasting customer experience and to increase store traffic as well as the average unit retail, retailers like Victoria's secret are remodeling or converting existing locations to improve the shopping experience. To keep the brand fresh, the Victoria's Secret team, for example, updates its store design every five to six years. In 2003, the New York's Herald Square store location was updated to reflect trends in lingerie and beauty products. The goal was to create a shopping experience representative of the Victoria's Secret lifestyle: sophisticated, sexy, modern, feminine and loaded with attitude (Hanson, 2003).

In the past decade, many manufacturers have opened their own retail stores as well, reducing their dependence on retailers while potentially increasing sales. This also permits manufacturers to showcase an entire line of products, to enhance brand awareness, to test new products, and to directly collect customer feedback. It also carries the risk of alienating retailers who carry the same merchandise. Some manufacturers have also established outlet stores to move older inventory.

According to data from the NPD Group Inc., in 2002, discount stores accounted for 31% of apparel sales, specialty stores for 25%, department stores for 19% and national chains 16%. The remaining 9% of sales came from channels like direct mail, internet vendors, and factory outlets.

3.4 Supply Chain Structure

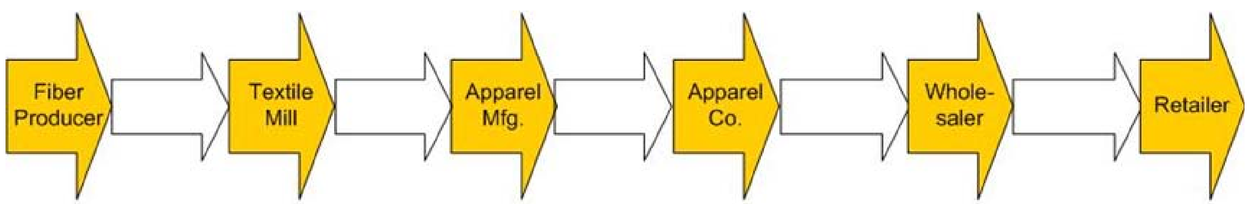


Figure 3 Typical Apparel Supply Chain

As illustrated in the Figure 3, the textile and apparel channel consists of different components. Broadly speaking, the industry is composed of six different segments: fiber producers, textile mills, apparel manufacturers, apparel companies, wholesalers and retailers of apparel. In addition, trading companies play the role of intermediaries at various stages of the chain.

Segments of channel are supported by related industries such as textile and apparel machinery, and chemicals used in manufacturing and finishing fabrics. Figure 4 illustrates the various steps that go into making a garment from scratch.

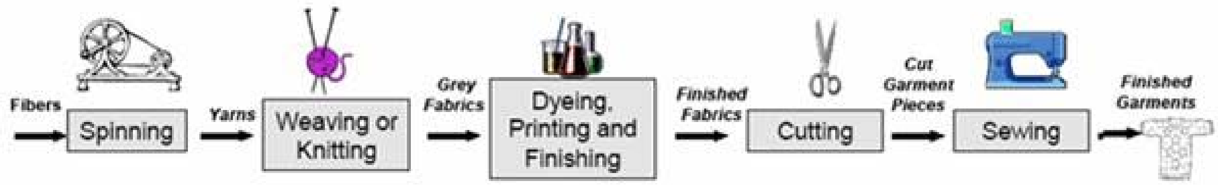


Figure 4 Major Production Steps in Apparel Production
Source: Compiled by U.S. International Trade Commission

The chain begins with agricultural and chemical suppliers, who provide natural or synthetic fibers. Many different types and sizes of firms supply natural fibers such as cotton and wool. The natural fiber suppliers are very fragmented and are located both within the US and outside. For example, many countries including India and a few countries in South America specialize in cotton production, Australia specializes in wool production, etc. Some U.S.-based firms like Du Pont produce large supplies of synthetic fibers and hold the majority of the shares in the market, although developing nations like China and Taiwan offer significant competition.

Next in the chain are textile firms, which are responsible for spinning fiber into yarn, knitting and weaving operations. These firms make fabrics from yarns. This part of the chain is highly fragmented and most of these companies are small-to-medium-sized worldwide.

Once fabrics are made and finished they are sent to apparel manufacturers to make finished apparel products. This part of the industry is characterized by a highly labor-intensive assembly process and low barriers to entry (and exit). As a result, a large number of small and medium–sized enterprises (SMEs) have sprung up in many low labor cost countries.

Finished apparel products are sold, either directly or through wholesalers, to a variety of retail outlets.

Some US specialty retailers, like Victoria’s Secret, are equipped with vertically integrated factories that manufacture and deliver goods directly to the company without the involvement of third party intermediaries.

In general, apparel sold in the United States is made both domestically and internationally. As, discussed in chapter 5, most sourcing strategies are based around the type of product being sourced. Typically, different supply chains are chosen based on whether the product being sourced is a fashion item or a basic item. A fashion item is one which has a short product life-cycle and remains in style for a short period of time. A basic product never goes out of style and is sold year to year. Some companies, like Victoria’s Secret, choose a mix of fashion and basic items in order to ensure sustained profitability and customer satisfaction.

Figure 5 illustrates this sourcing strategy for a typical US retailer based on the type of product to be produced.

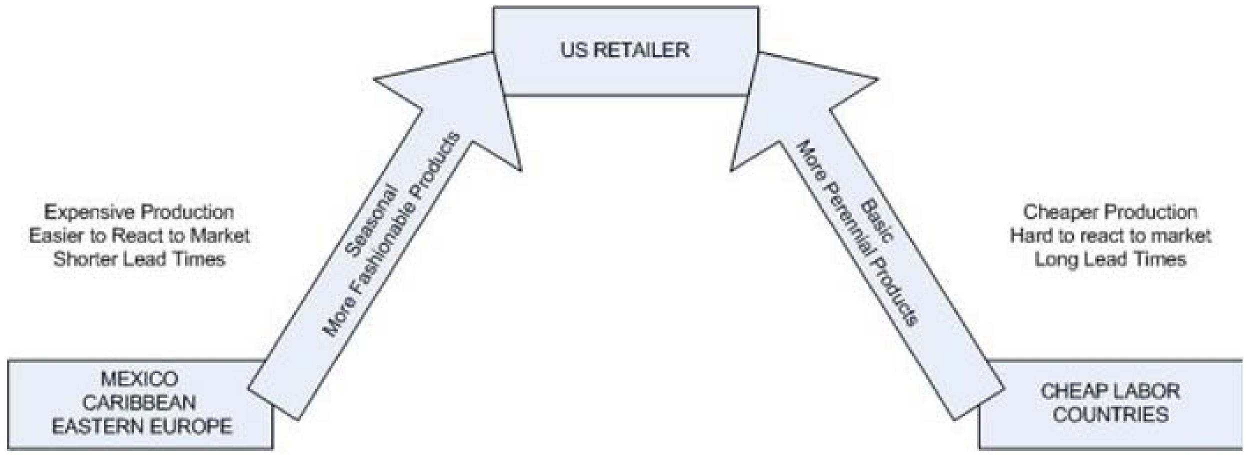


Figure 5 Sourcing Model for a typical U.S. Apparel Retailer
Not indicative of Victoria's Secret's Sourcing Model

This figure illustrates the trade-offs between transportation lead-times and cost of labor. Countries like Mexico and others in the Caribbean basin and Eastern Europe ensure proximity to the customer at a higher cost of labor. In contrast, counties like China and India provide cheap labor, but transportation lead-times are much longer. As a result, fashion products which have higher margin and shorter life-cycles are sourced using the former option and basic products, which have lower margins, are typically sourced using the latter option.

3.5 Trends and Drivers of Supply Chain

This segment discusses prevalent trends and drivers in the apparel supply chain. Most trends affecting apparel manufacturers today are driven by consumer demand and relate to the size of the various demographic groups, their specific needs, shopping patterns, and spending power. Changing styles in workplace and leisure attire are also influencing retail and manufacturing operations.

3.5.1 Sourcing Trends

From the point of view of apparel sourcing, there is an expectation of increased "off-shore" production from the Far East. Moreover, because of the removal of export quotas in 2005, there is expected to be a reallocation of production between countries in these sourcing regions. A strong position is expected for China.

3.5.2 Distribution Channels

From the point of view of the distribution channel, it is expected that the market share for the mail-order channel as well as the internet share of total mail-order distribution, will be on the rise in the next decade (Standard and Poor's, 2004). In terms of order fulfillment, there is increased pressure due to consumer requirements, leading to shorter fulfillment lead-times as well as shorter concept-to-market times. Product lifecycles in the retail channel are shortening, leading to an increased number of new product launches in retail outlets. There is also a trend toward increased distribution of tailor-made apparel and footwear merchandise because of new supply chain technologies. For instance, on its website, Nike, a well known shoe brand, provides the opportunity to customize a shoe according to individual customer preferences. Lands' End, a division of Sears, Roebuck and Co., provides an online tool on its website called the "My Virtual Model". This tool helps a shopper in trying Lands' End clothing on a virtual model that is practically a mirror image of the shopper.

Last but not the least, an important trend in the apparel segment is the continued pressure to reduce lead-times. There is a constant shift from seasonal collections to reproduction and replenishment collections. Pressure to decrease lead-times is causing a shift to faster transport modes, from sea to inter-modal sea/air to complete air. For replenishment collections, there is a trend towards local inventory points and express deliveries, and for reproduction collections, a trend towards CAD/CAM and flexible manufacturing systems.

Overall, three distinct delivery schedules are emerging (DHL Logistics, 2005):

- Long-term: Collections which are conceived up to one year in advance.
- Mid-term: Mini-collections which are worked out about six months in advance and provide the opportunity for continuous supply of new products in the stores, thereby giving customers the impression that there is always something new available.
- Short-term: Collections designed in response to the first results of the season.

Flexibility requirements can only be met by a limited number of suppliers and thus most players will be using these three schedules in combination. A few players will specialize, e.g. Zara, a Spanish Retailer (as one of the best known examples) has specialized in short-term collections only.

3.5.3 Market Concentration

There is a trend toward increased market share for vertically integrated retail chains and specialty stores. Global expansion by retail chains from home market to other areas of consumption has taken place. For example, European retailers like Zara and H&M have successfully expanded to the U.S. Recent years have seen aggressive consolidation via mergers and acquisitions, to share resources to bring efficiencies to the global apparel supply chain. Table 1 shows recent mergers and acquisitions activities within companies across the United States.

APPAREL COMPANY MERGERS & ACQUISITIONS — 2003–04

CLOSING DATE	ACQUIROR	TARGET	APPROXIMATE VALUE
7/6/04	Polo Ralph Lauren	Certain assets of RL Childrenswear Company LLC	$240 million
6/30/04	VF Corp.	Vans Inc.	$396 million
6/21/04	Oxford Industries	Ben Sherman Ltd	$146 million
6/21/04	Dick's Sporting Goods	Gaylan Trading	$362 million
6/18/04	Jones Apparel Group Inc.	Maxwell Shoe Co. Inc.	$346 million
6/17/04	Reebok	The Hockey Company	$204 million, plus the assumption of $149 million in debt
6/15/04	VF Corp.	Kipling Brand	$185 million
5/3/04	Quiksilver	DC Shoes	$144.2 million
2/3/04	Kellwood Co.	Phat Fashions	$140 million, plus contingent payments
12/1/03	Jones Apparel Group Inc.	Kasper	$259.3 million
12/1/03	Liz Claiborne	Enyce Holding	$121.9 million
9/4/03	Nike	Converse Inc.	$310 million
8/27/03	VF Corp.	Nautica	$587.6 million
6/13/03	Oxford Industries	Viewpoint Intl. and its Tommy Bahama lifestyle brand	$250 million, plus contingent payments
4/7/03	Liz Claiborne	Juicy Couture	$53 million, plus contingent payments
2/12/03	Phillips Van Heusen	Calvin Klein	$401.6 million
2/4/03	Kellwood Co.	Briggs NY	$145.7 million

Source: Company reports.

Table 1 *Source: Standard &Poor's Apparel and Footwear Industry Survey 2004*

Table 2, at the end of this chapter, shows top performing companies in the apparel, accessories and luxury goods market based on operating revenue and net income.

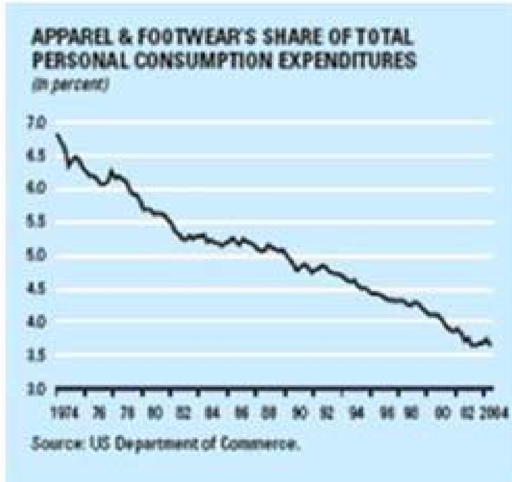


Figure 6 Source: Standard & Poor's *Apparel and Footwear Industry Survey 2004*

Last, the relative share of consumer spending on clothing has been consistently decreasing (Standard and Poor's, 2004), as shown in Figure 6. The primary reason for this decreased share is price deflation. Average selling prices for most apparel and footwear have been in long-term decline due to factors including the continued influx of imports, retail promotions, and market share gains by discounters. Other factors may include increased spending on fashion accessories compared to apparel. Therefore, although overall total dollar sales of apparel and footwear have risen since 1999, average selling prices have declined, as indicated by the apparel consumer price index (CPI) published by the Bureau of Labor Statistics (BLS). According to BLS data, US apparel prices fell five years in a row beginning in 1998, as shown in Figure 7.

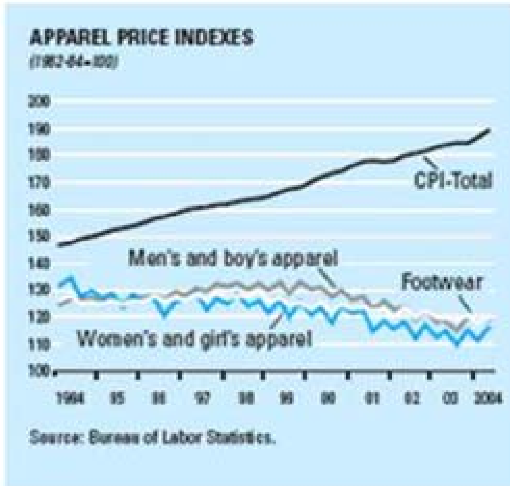


Figure 7 Source: Standard & Poor's Apparel and Footwear Industry Survey 2004

3.6 Supply Chain Challenges and Opportunities

In the past, retail stores often carried apparel products months in advance of the season in which they would be worn. Times have changed, however, and consumers nowadays tend to buy closer to need. To meet this demand, manufacturers have had to shorten design, development, production, and distribution cycles.

US apparel markets continually demand fashionable new products and yet it often takes many years for most companies to bring new products to market. Most apparel production, even today, is typically planned far in advance, based on highly speculative forecasts. Long lead-times, distances and hand-offs between members of the supply chain create tremendous losses for retailers due to mark-downs, stock-outs, high inventory levels and shrinkage. In an effort to mitigate these losses, the players in this industry have tried to shift risk either back to the suppliers or forward to their customers.

Having realized that there are huge gains to be materialized by bringing efficiencies into the supply chain, players like Limited Brands are working collaboratively with their suppliers on product and process innovation. In fact, Victoria's Secret (see chapter 6), the lingerie business of Limited Brands, executes two parallel supply chains for smooth delivery of its products based on whether the product is a basic or fashion item. Although two separate supply chains strategies seem necessary they inevitably add a great deal of complexity to the overall operation. We explore this possibility in chapter six.

Operating Revenues

Ticker	Company	Yr. End	Million $ 2003	2002	2001	2000	1999	1998	1993	Compound Growth Rate (%) 10-Yr.	5-Yr.	1-Yr.
APPAREL, ACCESSORIES & LUXURY GOODS‡												
ASHW	§ ASHWORTH INC	OCT	149.4	127.5	124.7	125.9	107.9	107.3	45.8	12.5	6.8	17.2
COH	† COACH INC	JUN	953.2	719.4	616.1	548.9	507.8	NA	NA	NA	NA	32.5
FOSL	§ FOSSIL INC	DEC	781.7	663.9	546.3	505.1	419.1	304.8	105.1	22.2	20.7	17.7
HGGR	§ HAGGAR CORP	SEP	484.0	483.2	446.4	435.3	437.6 A	405.4	296.6	2.0	3.6	0.2
JNY	* JONES APPAREL GROUP INC	DEC	4,375.3 A	4,340.9 A	4,097.2 A	4,142.7 A	3,150.7 A	1,685.2 A	546.1 A	23.1	21.0	0.8
KWD	§ KELLWOOD CO	# JAN	2,346.5 A,C	2,204.7 A	2,281.8	2,362.2 A	1,565.3 H	2,151.1 A	1,203.1 A	6.9	1.8	6.4
LIZ	* LIZ CLAIBORNE INC	DEC	4,241.1	3,717.5	3,448.5 A	3,104.1	2,806.5	2,535.3	2,204.3	6.8	10.8	14.1
GOSHA	§ OSHKOSH B'GOSH INC -CL A	DEC	417.3	437.0	463.1	453.1	429.8	423.2	340.2	2.1	(0.3)	(4.5)
OXM	§ OXFORD INDUSTRIES INC	# MAY	1,116.6	764.6	677.3	812.5	839.5	862.4	624.6	6.0	5.3	46.0
PVH	§ PHILLIPS-VAN HEUSEN	# JAN	1,582.0 A	1,405.0	1,431.9	1,455.5	1,271.5	1,303.1	1,152.4	3.2	4.0	12.6
ZQK	§ QUIKSILVER INC	OCT	975.0	705.5 A	620.6 A	519.4 A	445.9	317.6	95.2	26.2	25.1	38.2
RML	§ RUSSELL CORP	DEC	1,186.3	1,164.3	1,160.9 C	1,217.6 A	1,142.2	1,180.1	930.8	2.5	0.1	1.9
VFC	* VF CORP	DEC	5,207.5 A,F	5,083.5 D,F	5,518.8 F	5,747.9 A,C	5,551.6 A	5,478.8 A	4,320.4	1.9	(1.0)	2.4
FOOTWEAR‡												
BWS	§ BROWN SHOE CO INC	# JAN	1,832.1	1,841.4	1,755.8	1,684.9	1,594.1	1,539.9	1,597.8 D	1.4	3.5	(0.5)
KSWS	§ K-SWISS INC -CL A	DEC	429.2 D	290.4 C	236.1	221.6	285.5	161.5	149.6	11.1	21.6	47.8
NKE	* NIKE INC -CL B	# MAY	12,253.1	10,697.0	9,893.0 C	9,488.8	8,995.1	8,776.9	3,789.7	12.5	6.9	14.5
RBK	* REEBOK INTERNATIONAL LTD	DEC	3,485.3	3,127.9	2,992.9	2,865.2	2,899.9	3,224.6	2,893.9	1.9	1.6	11.4
SRR	§ STRIDE RITE CORP	NOV	550.1	532.4	529.1	548.3	572.7	539.4	582.9	(0.6)	0.4	3.3
TBL	† TIMBERLAND CO -CL A	DEC	1,342.1	1,190.9	1,183.6	1,091.5	917.2	862.2	418.9	12.3	9.3	12.7
WWW	§ WOLVERINE WORLD WIDE	DEC	888.9 A	827.1	720.1	701.3	665.6	669.3	333.1	10.3	5.8	7.5
OTHER COMPANIES WITH SIGNIFICANT APPAREL OPERATIONS												
COLM	COLUMBIA SPORTSWEAR CO	DEC	953.6 A,C	816.3	779.6	614.8	470.5	427.3	NA	NA	17.4	16.8
HMX	HARTMARX CORP	NOV	561.8 F	570.3 F	601.6 A,F	680.6 F	726.8 A,F	725.0 A,F	732.0 F	(2.6)	(5.0)	(1.5)
NAUT	NAUTICA ENTERPRISES INC	# FEB	NA	693.7	692.1 A	627.7	621.3	552.7	192.9 F	NA	NA	NA
RL	POLO RALPH LAUREN CP -CL A	# MAR	2,649.7	2,439.3	2,363.7	2,225.8	1,955.5 A,C	1,726.9	NA	NA	8.9	8.6
TOM	TOMMY HILFIGER CORP	# MAR	1,875.8	1,888.1	1,876.7 A	1,880.9	1,977.2	1,637.1 A	227.2	23.5	2.8	(0.6)

Net Income

Ticker	Company	Yr. End	Million $ 2003	2002	2001	2000	1999	1998	1993	Compound Growth Rate (%) 10-Yr.	5-Yr.	1-Yr.
APPAREL, ACCESSORIES & LUXURY GOODS‡												
ASHW	§ ASHWORTH INC	OCT	2.5	2.8	6.6	3.8	5.3	4.8	2.0	2.2	(12.3)	(11.3)
COH	† COACH INC	JUN	85.8	64.0	38.6	16.7	NA	NA	NA	NA	NA	34.0
FOSL	§ FOSSIL INC	DEC	58.9	43.7	55.9	51.8	32.2	18.9	10.7	18.6	25.5	34.9
HGGR	§ HAGGAR CORP	SEP	8.0	(8.7)	9.3	9.4	8.0	3.7	12.4	(4.3)	16.4	NM
JNY	* JONES APPAREL GROUP INC	DEC	332.3	236.2	301.9	188.4	154.9	121.7	41.3	23.2	22.2	40.7
KWD	§ KELLWOOD CO	# JAN	42.0	37.7	60.8	41.0	2.0	42.7	28.7	3.9	(0.3)	11.3
LIZ	* LIZ CLAIBORNE INC	DEC	231.2	192.1	184.6	192.4	169.4	184.6	218.8	0.6	4.6	20.4
GOSHA	§ OSHKOSH B'GOSH INC -CL A	DEC	32.0	32.8	32.2	32.4	29.3	22.6	15.7	7.4	7.3	(2.3)
OXM	§ OXFORD INDUSTRIES INC	# MAY	20.3	10.6	15.3	23.4	26.4	24.6	14.8	3.2	(3.8)	92.3
PVH	§ PHILLIPS-VAN HEUSEN	# JAN	30.4	10.7	30.1	16.9	12.9	(66.6)	37.9	(2.2)	NM	185.0
ZQK	§ QUIKSILVER INC	OCT	37.6	28.0	31.8	26.6	18.0	12.6	0.4	NM	24.3	34.2
RML	§ RUSSELL CORP	DEC	46.9	(55.5)	14.5	8.4	(10.4)	54.4	82.2	(5.5)	(2.9)	NM
VFC	* VF CORP	DEC	364.4	137.8	267.1	366.2	388.3	350.9	237.0	4.4	0.8	164.4
FOOTWEAR‡												
BWS	§ BROWN SHOE CO INC	# JAN	45.2	0.9	36.4	35.5	23.7	(20.9)	4.7	25.5	NM	4,660.0
KSWS	§ K-SWISS INC -CL A	DEC	28.7	23.3	21.1	34.3	12.5	4.2	9.8	11.3	47.1	23.1
NKE	* NIKE INC -CL B	# MAY	740.1	668.3	589.7	579.1	451.4	399.6	365.0	7.3	13.1	10.7
RBK	* REEBOK INTERNATIONAL LTD	DEC	131.5	102.7	80.9	11.0	23.9	135.1	114.8	1.4	(0.5)	28.0
SRR	§ STRIDE RITE CORP	NOV	24.1	19.0	25.2	26.4	21.1	19.8	61.5	(8.9)	4.0	27.0
TBL	† TIMBERLAND CO -CL A	DEC	90.2	106.7	124.1	75.2	59.2	47.3	12.9	21.5	13.8	(15.5)
WWW	§ WOLVERINE WORLD WIDE	DEC	47.9	45.2	10.7	32.4	41.7	41.5	4.6	26.4	2.9	5.9
OTHER COMPANIES WITH SIGNIFICANT APPAREL OPERATIONS												
COLM	COLUMBIA SPORTSWEAR CO	DEC	102.5	88.8	58.6	33.0	32.7	39.3	NA	NA	21.1	15.4
HMX	HARTMARX CORP	NOV	3.4	(13.9)	8.6	1.6	14.6	25.2	(220.2)	NM	(33.0)	NM
NAUT	NAUTICA ENTERPRISES INC	# FEB	20.7	17.3	46.1	46.2	58.7	56.4	10.5	7.0	(18.2)	19.9
RL	POLO RALPH LAUREN CP -CL A	# MAR	174.2	172.5	59.3	147.5	90.6	147.6	NA	NA	3.4	1.0
TOM	TOMMY HILFIGER CORP	# MAR	(83.6)	134.5	131.0	172.4	173.7	113.2	14.6	NM	NM	NM

Note: Data as originally reported. ‡ S&P 1500 Index group. * Company included in the S&P 500. † Company included in the S&P MidCap. § Company included in the S&P SmallCap. # Of the following calendar year. **

Table 2 Source: Standard &Poor's Apparel and Footwear Industry Survey 2004

4 Limited Brands Case Study

Formerly called “The Limited”, Limited Brands operates more than 3,700 stores in the United States (Limited Brands Annual Report 2004). Its apparel segment includes The Limited Stores and Express. Its intimate products business, Victoria's Secret (lingerie stores, catalogs and online business), accounts for more than half of the company's revenues. Its personal care product business includes Bath & Body Works, Henri Bendel (also sells apparel) and White Barn Candle Co. (candles and fragrances). The company also encompasses a wholly-owned subsidiary, apparel maker Mast Industries. Limited Brands is closely controlled by founder and Chief Executive Officer Leslie Wexner, whose family owns about 17% of the company (Hoover’s Online).

The company is currently organized into three groups: apparel, which includes Express and The Limited Stores; beauty and personal care, which includes Bath & Body Works; and lingerie, which includes Victoria's Secret.

4.1 Company History

According to company lore, after a disagreement with his father in 1963 over the operation of the family store (Leslie's), Leslie Wexner, then 26, opened the first Limited store in Columbus, Ohio, with $5,000 borrowed from his aunt. Leslie Wexner's desire was to focus on moderately priced fashionable attire for teenagers and young women (Hoover’s Online).

The Limited went public in 1969 with five stores. Rapid development of large malls spurred Limited’s growth to 100 stores by 1976. Two years later, The Limited acquired Mast Industries, an international apparel purchasing and importing company. The company opened Express in 1980 to serve the teen age market (Hoover’s Online).

Between the 1980s and early 1990s, the company went on a buying spree, growing primarily through acquisition. In 1982, Limited purchased Lane Bryant (a plus size brand) and Victoria's Secret (lingerie) and in 1985, Limited bought The Lerner Stores (budget women's apparel) and Henri Bendel (high fashion). In 1988, The Limited bought sportswear retailer Abercrombie & Fitch (A&F). The Limited introduced several in-store shops, including Cacique (French lingerie) in 1988, and Limited Too (girls' fashions), which were expanded into stand-alone stores. It also launched Structure (men's sportswear) in 1989 and Bath & Body Works shops in 1990. These stores were often strategically clustered together within a mall (Hoover’s Online).

In 1993, the company closed many of The Limited and Lerner stores. It opened four Bath & Body Works stores in the UK (its first non-US stores) to compete with British rival The Body Shop. In 1995, with 17 operating businesses, the company decided to trim some of its poorly performing divisions. A portion of Victoria's Secret, Cacique, and Bath & Body Works was sold to the public in 1995 and A&F was sold in 1996. In 1998, The Limited sold its remaining 84% stake in A&F (Hoover’s Online).

In 1997, the company closed more than 100 of its women's apparel stores; the next year it closed nearly 300 more companywide (excluding the Intimate Brands chains) and all but one of its Henri Bendel stores. Also in 1997, Intimate Brands closed the Cacique chain. In 1998, The Limited launched White Barn Candle Co. (candle and home fragrance stores). The following year the company spun off Limited Too, its most successful chain, as Too, Inc. The Limited (as well as Intimate Brands) declared a two-for-one stock split in 2000 (Hoover’s Online).

In 2001, the company sold its Lane Bryant chain to retail store operator Charming Shoppes. It also spun off its former subsidiaries, Alliance Data Systems (in which it retained about a 20% stake) and Galyan's Trading Co. (whose remaining 22% stake it sold off in 2004). In March 2002 The Limited bought back the remaining shares of Intimate Brands it did not already own and, over the course of the year, phased it into a business segment. The Limited also changed its name to Limited Brands later that same year. Also that year, the company sold off its remaining stake in Lerner New York and in late 2003 sold its Structure label (which it had re-branded as Express Men's) to Sears, Roebuck and Co. In 2004 it sold off 1.6 million shares of the plus-size United Retail Group Inc. after a decade of investment (Hoover’s Online).

With shrinking sales and store numbers in its apparel unit, Limited Brands is currently focusing on its star players, Victoria’s Secret and Bath and Body Works.

See Table 5 for historical timeline.

4.2 Company Strategy

The company strategy has evolved over time. Prior to 1995, the company’s strategy was primarily driven by a knock-off design, shop-and-copy system. During this period, the company’s merchants searched for forthcoming fashion designs, all over the world, especially in Europe, and produced merchandise inspired by these designs. Their strategy involved speed sourcing of the products and selling them out even before the original brand could actually be launched. By the early nineties, there remained little competitive advantage in this approach, as the rest of the world had figured out similar ways to do business (Limited Brands Presentation, 2005).

Between 1995 and 1998, the company strategically planned an overhaul, focusing on developing a distinct brand identity. The Limited became the largest employer of apparel designers in the world (as mentioned by a top executive). The company re-positioned itself to operate like an upscale consumer package company. With aspirations to be a large powerful brand that controlled its own retail distribution channels and seeking a consistent repeatable business, the company soon incorporated vertically integrated capabilities into its supply chain. In its quest to narrow its portfolio and create a distinct brand image, the company closed all of its poorly performing businesses, including the sale of its bank, and spun off or sold Abercrombie and Fitch, Lane Bryant and six out of seven Henri Bendel stores (Limited Brands Presentation, 2005).

4.3 Financial Performance

Between the years 1985 and 1992, the company compounded at an annual growth rate of 16.4%, and between 1992 and 1995 it compounded at an annual growth rate of 4.4% (Figure 8). Limited Brands has grown 5.8% in revenue from $8,445 million in the year 2003 to $8,934 million in the year 2004. This growth has been accompanied by a net profit growth of 2.1% (from 5.9% in 2003 to 8.0% in 2004). See Tables 3 and 4 at the end of the chapter for details of operating results. Figure 9 shows Limited Brands’ revenue and income over the past decade from 1995 through 2004.

Figure 8 Limited Brands Net Sales ($ Billion)

Figure 9 Limited Brands' Revenue versus Income

Source: Based on Historical Financial Data from Hoover's Online

A study done by Columbia Business School (Columbia Business School, 2003) states that Victoria's Secret enjoys healthy sales growth and robust operating margins, whereas its other units struggle to improve performance. Due to intense competition, operating profit margins and productivity at Bath & Body works have fallen significantly. The apparel segment is demonstrating improved performance, although Limited Stores still generates operating losses. Led by strong results at Express during 2002, operating margins at the apparel unit improved to 4.2% from 1.9% in 1999. While The Limited division remains unprofitable, evidence suggests that improvements may eventually lift it to profitability; thus the company views it as a viable unit. Figure 10 illustrates the sales percentage of Limited Brands by business division.

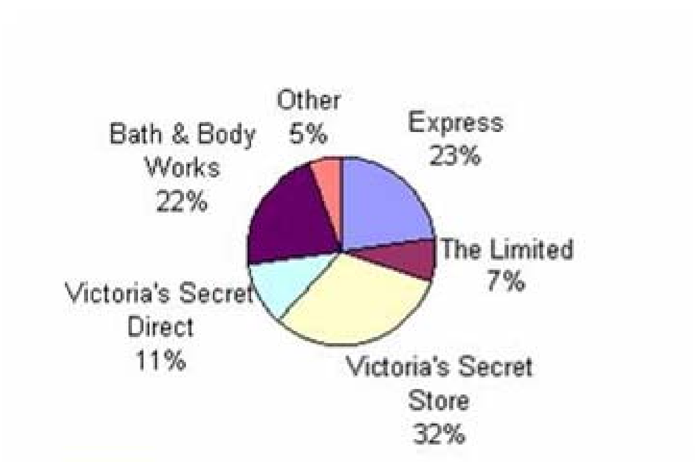


Figure 10 Limited Brands Revenue Pie

Source: Based on data from 2004 Annual report
"Other" includes corporate, Mast & Henri Bendel

4.3.1 Victoria's Secret Business Unit

Within Victoria's Secret, all three channels – Victoria's Secret Stores, Victoria's Secret Beauty and Victoria's Secret Direct – are experiencing revenue growth as well as profitability. As of year-end 2002, Victoria's Secret brand earned revenues over $3.6 billion versus $1.9 billion in 1995 (Columbia Business School, 2003). Victoria's Secret Stores' year-over-year same-store sales comparisons improved from -1% in 1995 to a peak of 12% in 1999. Amidst a difficult retailing environment, same store sales comparisons declined in 2000 and 2001, but rebounded in 2002.

The continued focus on bras drove a 2004 comparable store sales increase of 5%. This increase was primarily driven by the new Pink® sub-brand, and by continued growth in the bra category and the Beauty business, partially offset by declines in casual sleepwear (Limited Brands Annual Report 2004). Pink, Victoria's Secret's latest collection of intimate apparel aimed at 18 to 22 year-old customers, and "Angels," continue the brand strategy of introducing new products every four to six weeks in order to generate interest in the brand (Columbia Business School, 2003). Currently, two new lines, Very Sexy® and Body by Victoria®, are successful both in lingerie and in beauty. The glamorous "Very Sexy® for Him and Her" are new fragrance launches that build on this approach.

Victoria's Secret Direct, the catalog and online business, also experienced growth. Direct enjoyed a 13% increase in sales in 2002. The growth came from improved clothing assortment at more competitive prices and growth of its intimate apparel category, especially of panties and sleepwear. Direct now represents approximately a third of Victoria's Secret sales (Columbia Business School, 2003).

A 2001 "share of drawer" analysis indicated that one-third of the typical customer's lingerie drawer comes from the Victoria's Secret brand. Most of the drawer, however, consists of daily wear lingerie products, of which Victoria's Secret is a relatively lower percentage. Thus, the trend for the new product introductions will likely be toward more pretty, yet everyday, styles like the Body by Victoria® sub-brand (see chapter 5 for sub-brands), which is a line of everyday intimate apparel (Columbia Business School, 2003).

4.3.2 Other Business Units

Bath & Body Works showed a 12% increase in comparable store sales from year 2003 to year 2004 (Limited Brands Annual Report 2004). This growth was primarily driven by continued sales growth in the home fragrance, anti-bac and Daily Beauty Rituals product lines, as well as the successful launch of the Tutti Dolci product line. Moreover, sales increases were supported by successful semi-annual sales during both the Spring and Fall seasons. The apparel businesses showed dismal performance with an 8% decrease in comparable store sales at Express. This was driven by significant declines in almost all of the women's categories, primarily related to the poor performance of the fall season product assortment discussed previously.

4.4 Competitive Landscape

Because of a varied business portfolio, it is difficult to identify one company as a direct competition to Limited Brands. However, some individual business units face both direct and indirect competition. Victoria's Secret, for example, competes with Gap Body® directly, Bath and Body Works competes directly with Body Shop and indirectly with cosmetic sections within department stores. Apparel businesses like Express compete for a customer's share of wallet with companies like Gap, Banana Republic, H&M, Zara etc. Victoria's Secret is unique in this way. There doesn't seem to be present any head-to-head competition in the market at this point. However, Victoria's Secret competes, in a minor way, with lingerie brands in department stores, such as Sara Lee and Jockey. Victoria's Secret's sub-brand Pink, however, competes in the same space as Abercrombie & Fitch.

Hoovers identifies Gap, Inc, Sears, Roebuck and Co., and The TJX Companies, Inc. as Limited Brands' top three competitors (see Table 6 at the end of this section).

OPERATING RESULTS

COMPARABLE STORE SALES INCREASE (DECREASE)	2004	2003	2002
Victoria's Secret	9%	4%	6%
Bath & Body Works	12%	8%	(3%)
Apparel	(7%)	0%	3%
Total Limited Brands	4%	4%	3%

NET SALES (millions)	2004	2003	2002
Victoria's Secret	$4,232	$3,817	$3,586
Bath & Body Works	2,169	1,934	1,781
Apparel	2,490	2,697	2,711
Other	517	486	367
Total Limited Brands	$9,408	$8,934	$8,445

NUMBER OF STORES	2004	2003	2002
Victoria's Secret	1,001	1,009	1,014
Bath & Body Works	1,569	1,604	1,639
Apparel	1,207	1,297	1,382
Other	2	1	1
Total Limited Brands	3,779	3,911	4,036

SELLING SQUARE FEET (thousands)	2004	2003	2002
Victoria's Secret	4,868	4,735	4,663
Bath & Body Works	3,556	3,542	3,568
Apparel	7,340	7,726	8,031
Other	37	35	35
Total Limited Brands	15,801	16,038	16,297

SALES PER AVERAGE SELLING SQUARE FOOT	2004	2003	2002
Victoria's Secret	$648	$600	$581
Bath & Body Works	611	544	507
Apparel	331	342	331
Total Limited Brands	$491	$464	$440

Table 3 *Source: Limited Brands 2004 Annual report*

** Other Includes Corporate Mast and Henri Bendel*

BRAND RESULTS

VICTORIA'S SECRET STORES (Lingerie and Beauty)	2004	2003	2002
Sales (millions)	$3,113	$2,822	$2,647
Comparable store sales	9%	4%	6%
Number of stores	1,001	1,009	1,014
Selling square feet (thousands)	4,868	4,735	4,663
Sales per average selling square foot	$648	$600	$581
Average store size (selling square feet)	4,863	4,693	4,599

VICTORIA'S SECRET DIRECT	2004	2003	2002
Sales (millions)	$1,119	$995	$939
% Change	12%	6%	8%
Circulation (millions of books)	403	394	394
% Change	2%	0%	6%

BATH & BODY WORKS	2004	2003	2002
Sales (millions)	$2,169	$1,934	$1,781
Comparable store sales	12%	8%	(3%)
Number of stores	1,569	1,604	1,639
Selling square feet (thousands)	3,556	3,542	3,568
Sales per average selling square foot	$611	$544	$507
Average store size (selling square feet)	2,266	2,208	2,177

EXPRESS	2004	2003	2002
Sales (millions)	$1,913	$2,071	$2,073
Comparable store sales	(8%)	0%	2%
Number of stores	884	956	1,031
Selling square feet (thousands)	5,392	5,626	5,852
Sales per average selling square foot	$347	$361	$348
Average store size (selling square feet)	6,100	5,885	5,676

THE LIMITED	2004	2003	2002
Sales (millions)	$577	$626	$638
Comparable store sales	(5%)	0%	7%
Number of stores	323	341	351
Selling square feet (thousands)	1,948	2,100	2,179
Sales per average selling square foot	$285	$292	$284
Average store size (selling square feet)	6,031	6,158	6,208

Table 4 *Source: Limited Brands 2004 Annual report*

28 Limited Brands 2004 Annual Report

HISTORICAL TIMELINE

1963

The Limited opens its first store in Kingsdale Mall in Columbus, Ohio.

1969

Limited Brands first public stock offering is issued over the counter. 47,600 shares are offered at $7.25 per share.

1982

The Limited, Inc. is listed as LTD on the New York Stock Exchange.
Lane Bryant is purchased and consists of 207 stores and a mail order division, Brylane. Lane Bryant was sold to Charming Shoppes for $335 million in July 2001.
Victoria's Secret store and catalogue are purchased for $1 million.

1988

25 Abercrombie & Fitch stores and one catalogue are acquired for $46 million.
Limited Too, fashion for girls, is unveiled in Limited Stores.

1995

Initial public offering of Intimate Brands, Inc. establishes it as a fully independent company.

1998

Intimate Beauty Corporation is created to develop and build a portfolio of distinct beauty businesses. Victoria's Secret Beauty is the first brand in its portfolio.
50 Bath & Body Works Home stores are converted to The White Barn Candle Company stores to begin a home fragrance brand test.

The Limited, Inc. completes split-off of Abercrombie & Fitch.

Victoria's Secret launches e-commerce site VictoriasSecret.com, profitable since day one.

2002

The Limited, Inc. and Intimate Brands, Inc. recombine into The Limited, Inc.
aura science, a new prestige beauty brand resulting from the Intimate Beauty Corp./Shiseido joint venture, opens its first concept store at Easton Town Center in Columbus, Ohio.

The Limited, Inc. changes its name to Limited Brands to further emphasize the company's commitment to building a family of the world's best fashion brands.
Charming Shoppes repurchases 6.4 million of its common shares from Limited Brands Inc. for about $44.1 million, or $6.95 a share.

Limited Brands announces definitive agreement to sell Lerner New York/New York & Company. The terms include $78.5 million cash at closing, a $75 million subordinated note, and warrants for 15% of the common equity of the new company.

Table 5 Source: *Copyright© Trustees of Columbia University in the city of New York*

Key Numbers	Limited Brands	Gap	Sears[1]	TJX Companies		
Annual Sales ($ mil.)	9,408.0	16,267.0	**36,099.0**	14,913.5		
Employees	115,300	152,000	**247,000**	113,000		
Market Cap ($ mil.)	8,906.1	**18,355.3**	0.0	11,075.3		
Profitability	Limited Brands	Gap	Sears[1]	TJX Companies	Industry[2]	Market[3]
Gross Profit Margin	39.45%	**43.04%**	--	25.68%	39.15%	48.48%
Operations	Limited Brands	Gap	Sears[1]	TJX Companies	Industry[2]	Market[3]
Inventory Turnover	**5.5**	5.3	--	5.2	4.4	7.9
Growth	Limited Brands	Gap	Sears[1]	TJX Companies	Industry[2]	Market[3]
12-Month Revenue Growth	5.3%	2.6%	--	**11.9%**	8.2%	12.7%
12-Month Net Income Growth	(1.7%)	**11.7%**	--	0.9%	21.0%	32.6%
36-Month Revenue Growth	0.7%	5.9%	--	**11.6%**	8.3%	7.6%
36-Month Net Income Growth	**13.6%**	--	--	10.3%	34.4%	70.6%

Table 6 Limited Brands Competitive Landscape

Source: Hoovers

Data as of January 2005.

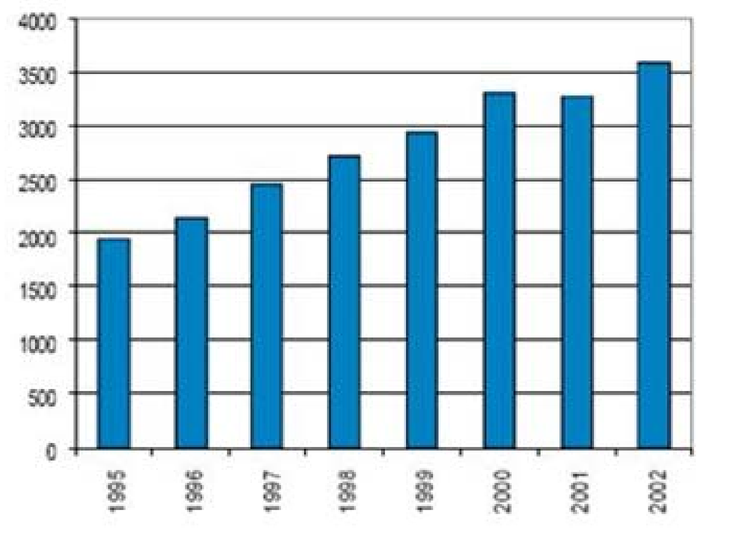
[1] *Data unavailable.*

[2] *Industry: Apparel Stores*

[3] *Public companies trading on the New York Stock Exchange, the American Stock Exchange,* and the NASDAQ National Market.

5 Victoria's Secret Stores

Victoria's Secret (VS) is the most profitable as well as the biggest revenue generating brand for Limited Brands. Its net sales for the year 2004 were $4,232 million with an operating income of $799 million (Limited Brands Annual Report 2004). Figure 11 illustrates Victoria's Secret's growth in annual sales from year 1995 to 2002.



Source: CSFB

Figure 11 Victoria's Secret Annual Sales, 1995-2002 ($ million)

Victoria's Secret comprises 3 sub-businesses: Victoria's Secret Stores (VSS), Victoria's Secret Beauty (VSB) and Victoria's Secret Direct (VSD). VSS primarily sells lingerie, including bras and panties, and sleepwear products and VSB sells beauty products, both through a nationwide network of stores. VSD sells VS lingerie, sleepwear as well as third party brands in the categories of apparel, shoes and accessories through its online store and catalogs. This case study focuses on Victoria's Secret's lingerie business.

In 2004, a total of 1001 VS stores with 4,868 thousand square feet in selling area generated net sales of $3,113 million, a 9% increase in comparable store sales from the year 2003. The sales per average selling square foot amounted to $648 (see Table 4).

5.1 Products

Victoria's Secret consists of several sub-brands or collections (see Figure 12). Each sub-brand can be said to focus on a central theme. For example, the recently introduced Victoria's Secret sub-brand called "Pink" is a new collection of intimate apparel aimed at a 19 year old woman (Limited Brands Interview, 2005), and the "Very Sexy for Him and Her" are new glamorous fragrance launches that build on its fragrance business. Each of these collections is offered in a variety of different styles based on the extent of coverage given by the bra, the configuration of the bra strap or even its entire silhouette. Finally, the consumer has the choice to shop by fabric type such as cotton, smooth stretch, lace & embroidered, and satin.

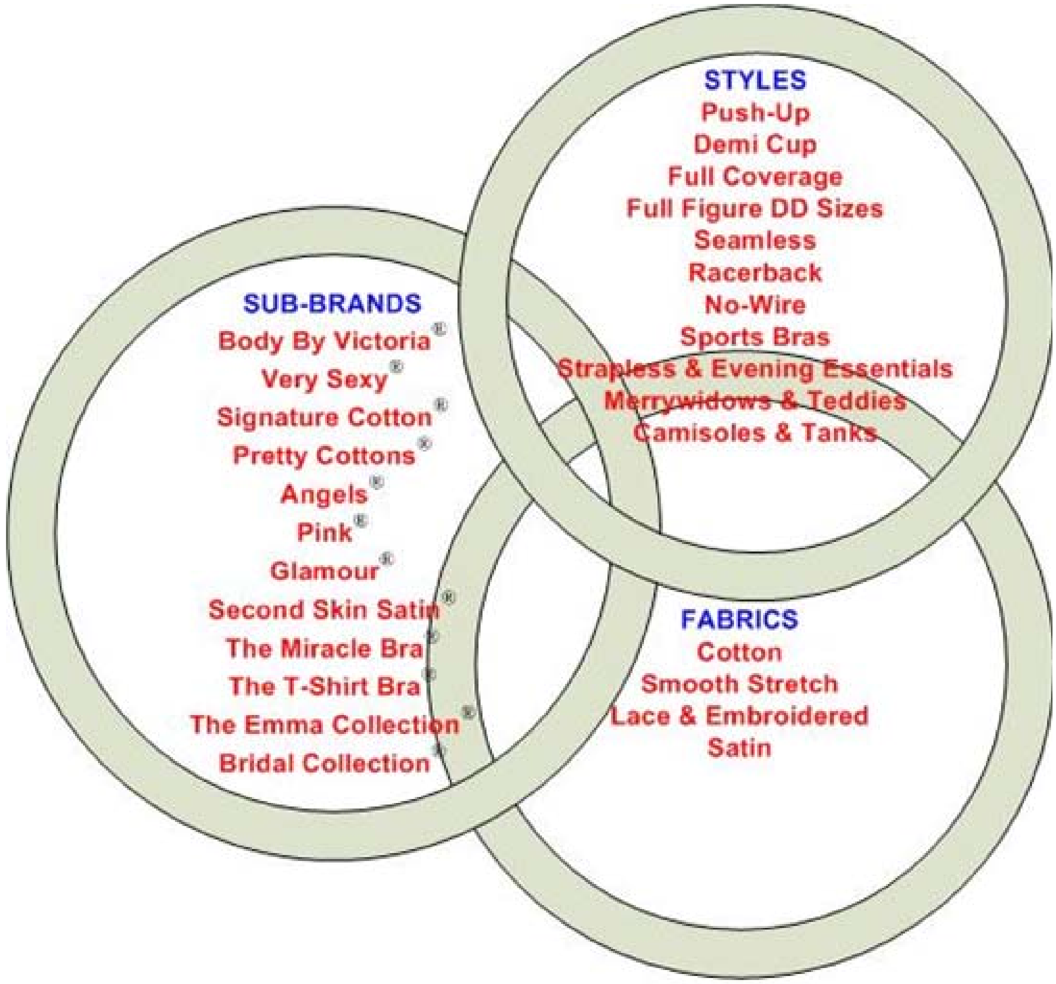


Figure 12 Figure describes Victoria's Secret Product Offering

Figure not drawn to scale

Source: Information collected from www.victoriassecret.com

Overall, the products carried by Victoria's Secret Stores can be divided into 3 broad categories: Launch Fashion Products, Non-Launch Fashion Products and Basic Products. About 60% of units in store are basic, 25% non-launch fashion and the remaining 15% are launch products (Limited Brands Interview, 2005). Basics consist of products which sell all year round and have styles and colors which can be sold in all seasons and for the most part, never go out of style. Beige Angel's bra, white and black bras from Body by Victoria are examples of basic products. Fashion products are loosely defined as items with styles, colors or silhouettes which typically sell for one season (1 season = 6 months) and then shift to regular replenishment. Launch products are fashion items which are heavily promoted and may even announce the introduction of a completely new category. These products involve special planning and are typically launched two times per year, in spring and fall. An example of a highly successful recently launched product is the IPEX® bra, by Body by Victoria®. The company also engages in about fifteen annual reconfigurations of its stores also termed as "floorsets". A floorset may or may not involve a launch.

5.2 Customer Segments

Victoria's Secret Stores is trying to be the dominant, young, sexy and sophisticated lingerie and beauty brand in the world. The target customer for all the Victoria's Secret sub-brands except for Pink® is a 26 year old woman (Limited Brands Interview, 2005). Victoria's Secret serves a wide range of customers with varied psychographics and demographics. On a household income scale, the VS customer loosely lies between 30-75 percentile range (Limited Brands Interview, 2005). With presence in almost all major malls in the United States, VSS aspires to become a destination brand, which means that a customer would be tempted to visit the malls just to see the VS store.

With the Pink® sub-brand, the space Victoria's Secret is trying to fill is "young and casual", a category which had been previously overlooked by Victoria's Secret. Pink® was developed in response to the fast growing Abercrombie & Fitch brand, which was once a part of The Limited.

Even though the Pink® products are cheaper than regular VS products, the strategy is more to be young than cheap. Out of the three key words describing the overall target customer above, "young" is most important. The goal is clearly to target a young demographic. Finally, the company sees VS as an “aspirational” brand, and as such, older women may be encouraged to buy Pink® products as well, as a 40 year old is likely to aspire to look like 30 rather than to look 60.

5.3 Competitive Landscape

Company management doesn’t perceive any direct head-to-head competition for its lingerie business. Minor competition comes from brands like Gap Body® and a few US based emerging competitors like Chico’s. Other competitors are American Eagle, which is testing a lingerie concept; department stores, which are trying to adjust their lingerie concept, and a few European lingerie brands that are attempting to enter the US market. However, an executive speculates that the maximum threat could be posed by companies like Wal-Mart who have the potential to create private label lingerie as well as to sell third party brands in the same space as Victoria’s Secret, and to possibly take over a whole category of products. Moreover, given that Victoria’s Secret is a business that is trading up and increasing its average unit retail (AUR), it might be even more attractive for players like Wal-Mart to under-price VS and to profitably grow up to Victoria’s Secret’s current AUR with a similar product that costs them 10-20% less (Limited Brands Interview, 2005). The executive observes that a shift in consumer preferences has happened in the last 7-10 years. He claims that a decade ago, it may not have been preferable to go to Wal-Mart or Target to shop for good apparel, but it has become quite the opposite in last five years. On the other hand, another executive notes that the fact that today’s women are buying more bras & a wider range of bras for several occasions including everyday, work, and casual, creates opportunity for product and fashion innovation brands like Victoria’s Secret.

5.4 Victoria's Secret's Supply Chain

The critical processes that make up the Victoria's Secret's supply chain are: 1) Product Design and Product Launch; 2) Merchandise Planning, Allocation and Forecasting; 3) Production & Sourcing; 4) Logistics; and 5) Store Operations. A design idea, from the point it is conceptualized to the point the product is delivered to the Victoria's Secret Stores, termed by the company as "Concept-To-Market", traverses through each of these processes comprising the supply chain.

Figure 13 helps positions these various processes among departments within the organizational structure of the Victoria's Secret Stores organization.

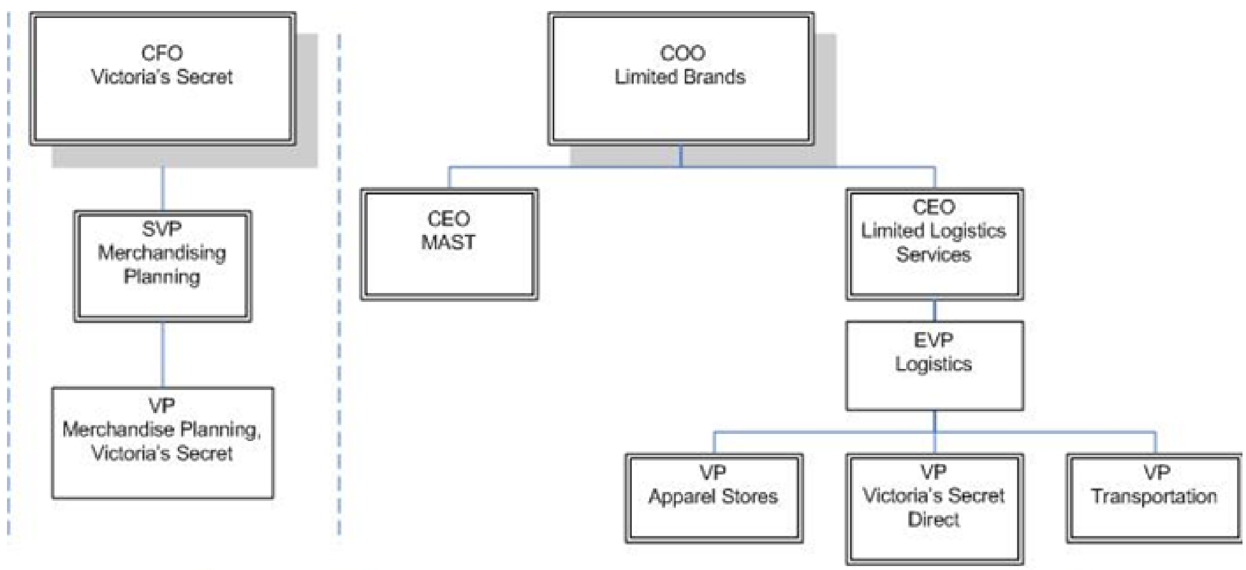


Figure 13 Victoria's Secret Organizational Chart

Merchandise Planning (Left of dotted line)

Sourcing and Logistics (Right of dotted line)

Source: Company Interview

These individual elements that make up the supply chain are described below.

5.4.1 Product Design and Launch

VS Stores has its design office in New York which is responsible for driving the growth for pre-existing sub-brands. There is also an enterprise-wide design department called the Limited Design Studio® (LDS) in New York. Limited Brands operates on a philosophy of “Open Innovation”. In an open-innovation environment, ideas can come from anywhere within or outside the company. There are at least 4 different Pathways to Innovation:

- VS Design studios: This is the primary pathway. The concepts of “Body by Victoria”, “Very Sexy” and “Angel” were created here.
- Limited Design Services: “Pink” was created in LDS.
- Marketing of 3rd party designer brands in the world: Sub-brands like “Intimissimi” and “Chantal Thomass”.
- Open commercialization: This consists of sub-brands which have been inspired by other concepts from all over the world. Typically, merchants travel all over the world attending trade shows in the look out for inspiration. An example of a product that followed this pathway is Sexy Little Thing®

Additionally, innovation can also take place at the functional level. For example, VS has 23% of un-lined bra category market share, compared to 45% - 52% of market share in the padded and lift support bras category (Limited Brands Interview, 2005). The IPEX® bra was developed in collaboration with innovative raw material manufacturers who successfully developed an un-lined, unpadded bra that provided adequate nipple coverage, ensuring a successful entry into the un-lined bra market.

After a concept is decided there are several ways of testing it. The Henri Bendel store in New York helps the individual brands to probe the outer reaches of what is “sexy”, what is “sophisticated” and what is “young”, and whether any of these images apply to brands being tested through in-store product placement. The store uses creative visual displays as an aid to market test. Victoria’s Secret also has its own set of laboratory stores where it tests new product. Few important design metrics used are:

- Sales/Unit/Store/Week of a newly launched bra like IPEX®
- Bra to Panty ratio
- Edit ratio: This is used in the middle of the design process to restrict the number of prototypes that are brought to design to make final decisions.

The following sections illustrate how the launch calendars are used to drive the product introduction process.

5.4.1.1 Concept-To-Market (Launch Calendar)

Concept-To-Market (see Figure 14) defines the path of all the activities involved in taking an idea from the point of conceptualization to the point of delivery to a store. The process is very detailed and well defined. A few key steps are described below from a high level standpoint.

The process starts with identifying a void in the market and sizing it. The company follows an Open Innovation model, described in detail in the Product Design section. For example, in the case of Pink®, the company decided to go after the young and casual customer. One of the reasons was the considerable profit pool that could be tapped and the other was the potential future competition arising from this category.

The next step involves pre-production or the development of prototype to see the range of merchandise that would address the life-style in mind. After the pre-production is done, the sourcing team takes responsibility for manufacturing enough products for the purpose of testing in stores. A store test is planned in number of stores, ranging from 5 to 50, and the results are read (Limited Brands Interview, 2005). As test results come in, typically, a number of iterations are required before the product is launch-ready. Finally, the production orders are placed with the Sourcing team and the product is delivered to stores with the help of the Logistics team.

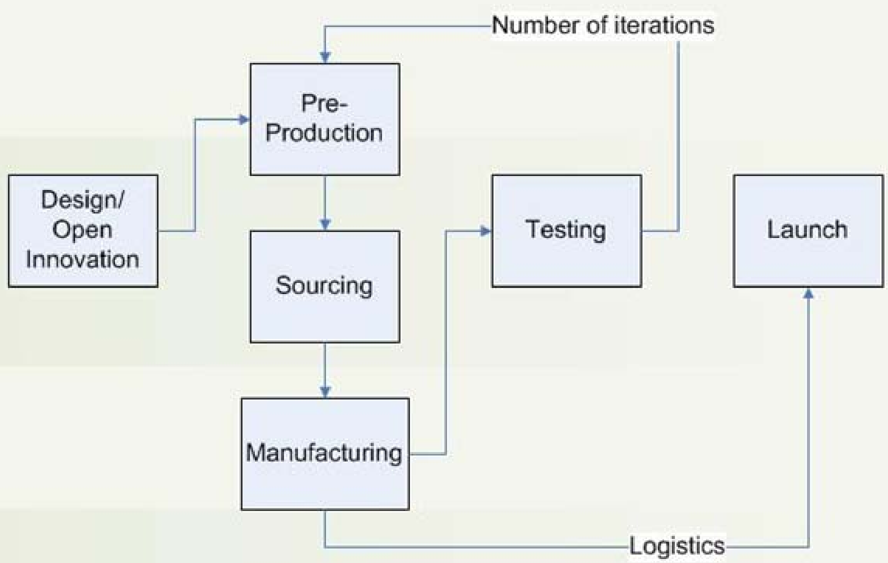


Figure 14 Concept-To-Market
Source: Company Interviews

All brands within Limited Brands including Victoria's Secret follow a Concept-To-Market calendar for launch products. There are clearly defined steps within this calendar that define the amount of time taken for each activity defined in the calendar. The current launch calendar is 76 weeks long.

The company identifies time-to-market as a critical aspect across every sub-brand including VS. There has been a consistent effort within the company for the past 1 ½ years, through a technology-based project called INSIGHT, involving external consulting firms, to shrink the concept-to-market calendar to 40 weeks or less. The effort is currently concentrated on one sub-brand and is planned to be implemented on 3 other sub-brands by the spring of 2006 (Limited Brands Interview, 2005).

5.4.1.2 Fashion Calendar

The activities involved in conceptualizing the fashion product and delivering it to stores constitute a fashion calendar. The fashion calendar involves similar tasks to those in the launch calendar except for the fact that these products are not going to be launched or heavily promoted. The current fashion calendar is 65 weeks long and efforts are ongoing to bring this time down to 40 weeks. The aspiration is to bring it further down to 30 weeks (Limited Brands Interview, 2005). The ultimate goal is to be able to react to fashion in season.

5.4.2 Merchandise Planning and Allocation

The Chief Executive Officer (CEO) of the brand, the Executive Vice President (EVP) of Planning, and the General Merchandise Manager (GMM) collaboratively formulate a merchandise growth strategy creating a roadmap with a three year planning horizon. The goal of this collaboration is to come up with a multiple year view of the growth of sub-brands and categories within sub-brand, like bras, panties and sleepwear in alignment with an overarching merchandise growth strategy.

This work, when ready, is communicated to the merchants, planning and design communities so that they understand both the requirements for the execution of such a plan, as well as the strategy behind it. This team then prepares a line plan which sets annual targets. The annual targets are then grouped into seasonal targets and, within seasons, into different floor sets or buy cycles. Once financial objectives are set, teams derive volume targets, taking into account the initial dollar mark up, potential mark down dollars and the targeted average unit retail (AUR). For example, the Angels Demi® bra might be chosen because it has commercial appeal and the potential to meet 20% of total volume of the plan being generated.

In the meantime, every brand, including Victoria's Secret, has a few global meetings on its calendar. These meetings include the Strategic Alignment Meeting and the Initial Edit Meetings with the General Merchandise Manager to rehash and rethink the product line. After the Initial Edit Meeting, the designers are given orders with a specific deliverable called the "Design ratio". A "Design Ratio" is the ratio in which various designs will be selected to be produced. The team then meets in the Final Edit Meeting to look at prototypes, which is followed by a Buy Meeting to write purchase orders (PO). When the Orders are written they are passed on to Victoria Secret Production group (VSP).

In-between the Final Edit Meeting and the Buy Meeting, the Merchandise Allocation team works with Merchandise Planning to identify which color variations will be continued and which ones will be dropped, and various lengths of introduction. The allocation team is also responsible for designing the flow to the VS stores based on the priorities set for different stores.

Additionally, the Planning group is bound by "Cost of Goods Available for Sale" (COGAFS) guidelines. COGAFS defines the target dollar amount of inventory at the Distribution Center

(DC) they have to operate with at any time, within each individual sub-brand. Inventory is measured in dollars/year/square foot. The COGAFS model originated in the apparel brands division to evaluate pockets of risk within inventory. VSS is somewhat risk averse, which implies that when there is an opportunity to fill a volume void to reach certain stock levels within a sub-brand, it is more likely that a basic product would be chosen over a fashion product.

Merchandise Planning reports to the Finance team. All brands including VS go through a quarterly business review process with the Chief Financial Officer (CFO) for next buy period. Physical store inventory is done once a year.

Different allocation methods are used depending on whether the product is a fashion item or basic replenishment. A push-based allocation model is commonly used for fashion and launch products. In this method, product is pushed from the DC to the stores based on the decision from the upstream authority, in this case from the Merchandise Allocation group. This is done because there is not much sales data available to dynamically regulate the product flow. Typically, an average store receives fashion merchandise about 3 times per week (Limited Brands Interview, 2005).

On the other hand, Victoria's Secret uses pull-based allocation for its replenishment of basic bra categories. In the pull method, shipments are sent to individual stores based on the POS data transmitted. This is done for basic products because for these products, consumer demand is relatively stable and historical point-of-sale (POS) data available. VSS uses an in-house forecasting tool which looks at the history, seasonal profile of style, and event history for 50 basic styles in basic colors to create a forward view of demand. In order for this forecasting tool to be functional, it has to be fed in with at least 3 months of historical selling data. The more selling history there is, the better the forecast accuracy. Some styles have considerable historical information and therefore all that is required is changing a few colors in case there are new color additions. The system is monitored on a regular basis and every 52 week forecast is evaluated and adjusted, if required, on a monthly basis.

Additionally, Victoria's Secret Stores uses a third party weekly store replenishment software tool. Every Monday, the allocation team looks at each store's past week sales at an individual stock keeping unit (SKU) level, its safety stock (SS) levels and cycle lead-times (DC to store, vendor to DC) etc. So, essentially, the 52 week forecast is evaluated weekly as well as monthly. Typically, an average store receives replenishment merchandise 2 times per week (Limited Brands Interview, 2005).

The actual frequency of store shipments from DC, for both fashion and replenishment products, ultimately depends on the type of product, the type of store (stores are divided into 7 tiers based on selling square footage and priorities are set in accordance with the tier ranking), and type of season, whether holiday or sale.

5.4.3 Sourcing and Production

80% of the merchandise sourcing and manufacturing for The Limited Brands is handled by Mast, which is a wholly owned division of the company. Mast's CEO also holds the title of SVP Production and Sourcing for Limited Brands (Limited Brands Interview, 2005). About twenty five percent of Mast's current revenue come from third party businesses outside of Limited Brands, like Abercrombie and Fitch, Chico's and Triumph, the largest intimate apparel company in the world.

The strategic sourcing process is carried out in following four steps. The process is initiated by the brand, in consideration of the overall company strategy. The group estimates possibilities of distortions at an operational level, like snowstorms, port strike, damages etc. This is followed by selection of key vendors based on criteria mentioned below and last, the worldwide trade situation is taken into account as well.

5.4.3.1 Plan Execution

Mast develops macro plans from sales forecasts and category breakdowns and allocates manufacturing to different factories. This plan is jointly approved in a Buy meeting, which is a cross-department venue between Mast and the brand. Mast executes the decisions made in the Buy meeting. At this point the PO (an official contract which commits to the content and time of delivery) is written and jointly supported by planning team, the merchant team and Mast.
Mast then lays out decision gates in the production critical path which define the points on the path to incorporate possible changes that might need to be applied to the original PO. These gates are typically placed at points when raw material is ordered, when it is cut, and when it is colored.

5.4.3.2 Sourcing Network

Every end of year, Mast undertakes a comprehensive study at a higher level, to profile countries based on their manufacturing and sourcing competencies. For example, one country may be better than others in particular areas of manufacturing -- like India in embellishments, or Europe in raw material innovation. Mast maintains a vendor council which includes finished goods and raw material producers. The business model is to work collaboratively. Manufacturing of finished intimate apparel is typically multiple sourced, fabrics are dual sourced, and raw materials are single sourced within one geographical site. Mast does business with multiple sites. While the actual transaction for raw material sourcing will likely be done by the finished goods manufacturing vendor, it is not a necessary condition. For example, for a launch product, it is quite common for Mast to place direct raw material orders and to own the liability until the manufacturer actually writes the purchase order for its raw material requirements.

Historically, Mast has done considerable business with Li & Fung, the largest apparel sourcing agents in the world. Over time, this outsourcing has been significantly reduced and Mast has relied on Li & Fung only in an occasional case where Mast doesn’t have presence in an area.

5.4.3.3 Vendor Selection

One of the primary drivers that govern the vendor selection process is “innovation”. Vendors are categorized as “Launch” or “Non-Launch”. The launch vendors are those that have developed and displayed essential manufacturing and technological capabilities to produce innovative products without strict commitments for minimum quantities. The non-launch vendors produce basics and more voluminous orders. There are a total of 20 vendors using 50 factories to produce intimate apparel for Victoria’s Secret (Limited Brands Interview, 2005). For apparel brands like “Express” this number is dramatically higher. Out of these 20 vendors, 7 to 8 vendors are launch vendors. These launch vendors do the vast majority of VS production. The second important criterion for vendor selection is “speed”. For a constant demand stream for basic bras which sell 12 months a year, 100% availability is very important. The selected vendors are able to work with a 4-week replenishment cycle.

Mast identifies China and Sri Lanka as important long term players, and India as a strategic satellite location for Sri Lankan production. Mast currently holds equity interest in several intimate apparel factories, including one in Sri Lanka and one in India. Over the years, these factories have developed significant manufacturing efficiencies with the help of Mast. Currently, about one-third of Victoria's Secret's total bra volume is produced by these two factories. The relationship with Sri Lanka dates back more than ten years. The Sri Lanka factory runs two shifts a day at full capacity and produces finished goods at costs which are comparable to China. This factory, which is vertically integrated, exports on average $350 million worth of finished goods to Limited Brands in USA.

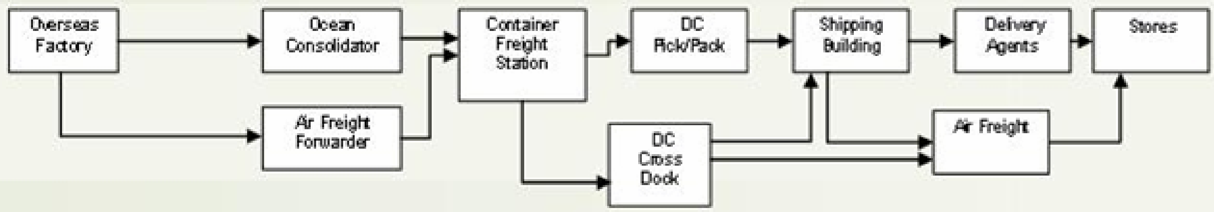
Other than Sri Lanka and India, Mast works with a set of three factory types: primary, secondary, and tertiary. In the primary factories, Mast utilizes about 90-100% of their production capacity, in secondary about 50%, and in tertiary about 10-20% (Limited Brands Interview, 2005). The ultimate goal for Mast is to consolidate all of its production so that every single product can be made in two of its large factories in India and Sri Lanka.

Mast produces a small percent of its goods in Europe. Apart from finished goods production, the Eastern-European region has been identified as particularly good for raw material innovation. Mast also does some of its production in the Israel/Jordan area where they work with a few vertically integrated plants.

5.4.4 Logistics

All logistics related activities for Limited Brands are handled by Limited Logistics Services (LLS). Even though LLS is an integral part of Limited Brands, it acts as a captive third party, billing businesses and centers as would an outside agency. As a result of these services LLS keeps some margin in-house. LLS operates under a Shared Service Model in which a service level agreement (SLA) is used as a contract between the individual businesses and LLS. This detailed contract lists metrics for measuring performance of services provided by LLS, as well as expectations from individual brands, in order to ensure a fixed customer service level on the part of LLS. Brands get daily, weekly and monthly updates from LLS about how they are doing against these performance metrics. If there is a disruption somewhere in the environment, LLS adjusts its production cycle time metrics accordingly. LLS also customizes this agreement based on specific requirements for each business unit and in most cases compares the rates it charges for these services to those of an outside provider.

On the whole, LLS plays three important roles: First, it acts as a logistics provider, ensuring smooth flow of goods from factory through to stores, and direct to consumers in case of VSD. It also manages all engineering related tasks within the company, and builds and maintains distribution centers and shipping buildings. Second, LLS is responsible for managing all the compliance-related activities for the flow and storage of product, including quality assurance and all activities associated with labor standards throughout the world. Last, LLS is responsible for procurement of all non-merchandise products for the enterprise including bags, boxes, and miscellaneous products required during a store launch. These products may or may not be directly associated with the sale of product. Figure 15 illustrates typical movement of product flow for Victoria's Secret.



Intimate Apparel Products Flow

Figure 15 **Movement of Product**

Source: Company Interviews

5.4.4.1 Inbound

Using an Internet-based module tied to an overseas factory, LLS gets a 48 to 72 hour notification for shipments pickup. LLS takes ownership of these products as soon as they are picked up from the factory. LLS may decide to bring in these goods in using either ocean transportation or air transportation. The ultimate decision to fly versus ship is made by the brand based on a variety of factors such as fashion versus basic products. As a loose rule, basic items (60% of total volume) are ocean shipped and fashion items (40% of total volume) are aired (Limited Brands Interview, 2005). The main reason behind the air shipments for fashion items is that fashion bras are light and have higher AUR. The benefits of airing these goods to ensure 100% availability in peak selling season more than offsets the cost of air transportation. Once picked up from the factory, shipments get consolidated at an ocean terminal with other products coming to Columbus, Ohio. An ocean shipment from the port of Hong Kong to the west coast and then to Columbus, Ohio typically takes about 21 days and slightly longer from Sri Lanka. In contrast, air shipment lead-time including customs clearance in the US takes from anywhere between 5-7 days (Limited Brands Interview, 2005). LLS works with 5 primary and 2 secondary freight forwarders who help clear these shipments from U.S. customs.

The ocean shipments typically arrive in the US west coast, where they are transported via inter-modal using truck or rail to Chicago and then trucked from Chicago to the Columbus distribution center (DC). Nearly 100% of apparel shipments come to the DC from vendors. In contrast, 75% of beauty products go through three cross-dock buildings straight to the stores and never visit the warehouse.

5.4.4.2 Warehousing and Distribution

The Columbus facility has seven distribution centers, out of which one is dedicated to Victoria's Secret Stores and one to Victoria's Secret Direct. On average, these distribution centers carry anywhere between 9-14 days worth of inventory (Limited Brands Interview, 2005). Approximately 90% of finished goods come packaged in cartons and 10% on hangers. The DC then performs value-added services like tagging, re-ticketing, monogramming, steaming, and hanging which cut back-room activity at the store level. These value-added services are particularly important in the case of launch products as they may involve making coordinated sets for store ready displays etc.

The store ready cartons are brought to the shipping building for a designated outbound delivery. The shipping building is equipped with highly automated consolidation mechanisms and once a picker chooses a box for outbound delivery, 97% of the times, it is not touched until it reaches the loading area. The shipping building ships 300 to 400 thousand cartons a day and has the capacity to ramp up to 1.2 million cartons at peak (Limited Brands Interview, 2005).

Finally, in a DC, productivity is measured by units/hour and in a shipping building, by cartons/hour.

5.4.4.3 Outbound

LLS has line haul relationships with domestic carriers like J.B.Hunt and Schneider who help to haul these boxes to a dedicated pool of about 45 delivery agents. Delivery Agents are responsible for cross-docking these incoming shipments and delivering to stores within approximately a two hour window, with a 97% on-time accuracy (Limited Brands Interview, 2005). In place of using third party carriers like FedEx or UPS, the company has developed its own logistics network which it claims is cheaper and more efficient for its distribution purposes. Moreover, as holiday and weekend deliveries are not uncommon, especially in the busy seasons, these service providers do not ensure weekend deliveries. For example, in peak holiday season, some stores like the Herald Square location in New York, require deliveries three times per day, which turns out to be very expensive if outsourced. LLS charges the brands published discounted sale rates from UPS and is still able to meet these demanding service levels (see next section). The shipments carried in a Delivery Agents' truck contain products which pertain to all the brands within a Mall. The agents deliver in short hauls delivering products to each Mall on their way.

Currently, it takes about 72 hrs for aired shipments out of Hong Kong to reach the Columbus DC. At peak, the DC can make this shipment store-ready in a day. From that point, it takes approximately 2.2 days on average to get to every US store. Therefore, fashion goods leaving Hong Kong on a Friday would make it to every store by the following Friday.

5.4.4.4 Measuring Success

Apart from the service level agreement (see beginning of Logistics section), one of the key tools that LLS uses to measure success is benchmarking. LLS formally brings in outside consulting firms to do a thorough logistics evaluation. Additionally, internal teams do informal evaluations every 24-30 months. Pricing evaluations are done twice per year. All such benchmarking activities performed so far have confirmed LLS is at an advantageous position in comparison to outside service providers due to internal capabilities like providing value-added activities and weekend deliveries. Moreover, LLS operates at a low margin and has relatively minor overhead costs in comparison to the large external 3rd party providers. The other aspect of success derives from a collaborative working relationship with the brands. For example, in one instance a Brand agreed to SKU rationalization to help solve capacity problems.

The other area where LLS uses well defined guidelines and metrics is in its relationship with stores. These metrics measure on time deliveries for replenishment goods as well as floorsets, along with many other key characteristics of performance.

Limited Logistics Services performs value-added services, internally managing the entire flow of products, and carrying out the measurements of these services to add competitiveness to the Victoria's Secret supply chain in a manner which is not easily replicable by an outside supplier. These have been identified, among others, as a set of tailored practices which help Victoria's Secret in its overall strategy (see chapter 6).

5.4.5 Victoria's Secret Store Operations

Victoria's Secret operates stores with varied store layouts. Victoria's Secret Beauty, for example, operates four different types of store concepts: Niche, Side-by-Side, 34th Street Design, and Free Standing Beauty Stores. Niche stores carry primarily lingerie and less than10% of beauty products. These are stores within malls. In the Side-by-Side store concept, the Victoria's Secret Beauty store and the Victoria's Secret lingerie store are located next to each other. The 34th Street Design refers to the Herald Square store design, on 34th street in New York City. This design involves a combination store which carries Victoria's Secret Beauty boxed in between the Victoria's Secret lingerie store. Finally, the company has several free standing beauty stores.

Each of these stores maintains a POS database with the help of a server setup in the back-room. The store prints a POS report two times per day to view inventory levels. Daily POS data is uploaded to the corporate office overnight. The corporate planning and allocation team looks at store sales and sell-through the following day and makes adjustments to the originally allocated orders. On the other hand, the stores are not equipped to have stock ledgers connected to store inventory, so it is difficult to ascertain exact inventory levels at any particular times, except for the last inventory count. The stores currently do not have the provision to order as and when they like from the distribution center, a process called "trickle pulling". This is planned to be available from July of 2006. A trickle pulling process would ensure each store has a stock-room which has basic replenishment products stacked like greeting cards. The stock-room typically takes 20% of space within a store. About one-third of Victoria's Secret stores also have off-site storage either in the mall or a nearby public storage facility for storing new merchandise, props and non-sale merchandise. Currently, stores are not integrated and so cannot view the inventory of other stores in the network. Store to store visibility of inventory is planned for 2006 -2007.

Finally, Finance doesn't have the provision of maintaining a store specific profit and loss statement. The only information that it receives is of top-line sale and payroll expenditure. For an accurate store-specific financial statement, accurate count of both merchandise and non-merchandise inventory along with an accurate information of store overheads is critical. If this information can be maintained, a store specific profit and loss statement will enable Victoria's Secret to exert tighter control over the performance of individual stores.

5.4.5.1 Store Performance Measurement

The performance of a store is measured by several metrics. The metric "Dollar Sales / Square Foot of Selling Area" helps compare the sales of different stores as well as same stores over a period of time. Another metric is "PAR". "PAR" is specifically used for a comparison of a Victoria's Secret Store to another competitive store in the same center or mall. So, for example, A Victoria's Secret Beauty store would be compared with Sephora, a leading fragrance retailer, or beauty counters within department stores. On this scale, a typical Victoria's Secret Store is observed to perform higher than any other competing retailer within its center or mall. A third metric is "Opportunity Volume" which quantifies the potential dollar losses because of stock-outs in a store. This metric is calculated based on the current inventory, the average dollar sales, and the number of transactions.

The sales force within a store in measured on the percent of sales plan, payroll, individual competencies and the percentage of damaged or stolen goods, also called "shrink". Victoria's Secret has a bonus structure in the form of a program called "Angels of Excellence Ranking". The ranking is in the order of bronze, silver, Gold, Platinum.

5.4.5.2 Returns and Mark Downs

The total returns for VS are only 2% of sales (Limited Brands Interview, 2005). The stores currently have no provision for reverse logistics. If a customer makes a return and the item is able to be replenished then it goes back on floor; if not, it is marked as stock-room damage. About 8-10% of returns in VS stores are damaged goods. June and July are the only two times in the year that Victoria Secret offers sales. This is the only time of the year when products which remain unsold are marked down.

5.4.6 Supply Chain Challenges and Opportunities

Victoria's Secret identifies that the current information technology infrastructure doesn't support a faster process. The company management is looking to the INSIGHT project to be an enabler to help supply chain reach the speed it needs. The company understands that it is essential to make design decisions closer to customer demand. Currently, Victoria's Secret has to contend with estimating what a consumer would want a year in advance based on current information which makes the forecasting process very difficult and results in errors. Merchandise Planning purchases sizes based on historical pattern of sell-through of the size curve.

On one occasion, out of the size curve that was purchased, two particular sizes, 34B and 36B, sold at twice the rate that they were projected at (16% versus 8% of volume), causing stock-outs and potential lost sales. Although this disparity in consumer behavior is difficult to predict in advance, a good IT infrastructure can enable Victoria's Secret to react to the actual demand faster through use of Point-of-Sale (POS) information immediately transmitted to its suppliers.

Lack of transmission of real-time POS data from stores to the corporate head-office has other disruptive effects as well. On holidays like Black-Friday, the day after Thanksgiving, when many consumers begin Christmas shopping, the corporate head-office has to deal with huge volumes of hourly phone calls from individual stores for updates on sales figures.

Another supply chain challenge from the merchandise planning viewpoint, is that the decision gates in Victoria's Secret's concept-to-market calendar are only planned for dropping styles out of line plan, and do not allow the flexibility of adding new styles closer to the selling season. When a style is dropped from the line plan, volume drops with it. And, at that point, the only alternative for the company is to produce another pre-existing category to fill the gap, if possible.

The last resort is to look at launch product. Therefore, along with the shortening of the calendar, if provisions can be made for adding styles, it will bring greater competency to the supply chain.

From the forecasting standpoint, it is somewhat challenging for Victoria's Secret to accurately "size" a fashion opportunity. The main reasons are that even when there is historical data that signals potential future success of certain category of products, it is difficult to understand what particular features within those products are the most attractive to the consumer. For example, within the Camisole style that has performed well, it is difficult to establish out whether it is the embellishment, the neckline or the length of the apparel that the customer finds most appealing.

Another challenge is that a lot of the growth in the next five years is likely to come from products in the basic category. Therefore product innovation in basic categories is of prime importance. The IPEX® is one key example of this type of an innovation. IPEX® belongs to the Body by Victoria® collection which is one of the oldest collections within VS. 63% of IPEX® was merchandised in the basic category and the remaining in fashion (Limited Brands Interview, 2005). At a $45 retail the IPEX® is the maximum selling bra in this price range for VS. As with the IPEX®, the company believes that for constant innovation within the existing sub-brands, it is important to work with the best component factory, the best manufacturing processes and the best people in the world -- who can constantly innovate new technologies like the shaving technique, the laminating technique, in case of the IPEX® bra, to name a few.

Last, from standpoint of human resource management, Victoria's Secret Stores faces challenges due to the fact that managers are not trained in managing store inventory, keeping cycle counts or verifying data integrity. The problem is magnified by a large number of scan errors. For example, if a customer buys one black bra and one white bra and the cashier rings them as two black bras instead, then inventory counts will show errors.

5.5 Victoria's Secret Direct

Victoria's Secret Direct sells product through its catalogs as well as through the web. The Direct business has shown a promising compounded annual growth of 10-12% in sales over the last 3 three years (Limited Brands Interview, 2005). From the year 2003 to 2004, the Direct business grew faster than the Victoria's Secret Stores business with a 12% increase in sales to $1,119 million and circulated 403 million catalogs in the year 2004.

Direct carries out its product development work in concert with Victoria's Secret Stores. Although it operates independently of Victoria's Secret Stores, and selects its own assortment of merchandise, it has regular brand meetings with Victoria's Secret Stores. Direct carries approximately 90,000 SKUs in the category of lingerie, shoes, apparel accessories and sleepwear, and beauty. Apparel constitutes about 40% of Direct's products, and intimate apparel is the remaining business. Apart from carrying its own brand, Direct also carries third party merchandise from brands like Calvin Klein. In comparison, Victoria's Secret stores carry only about 12,000 SKUs of its own brand. There exists only a 15-20% overlap in the SKUs sold between Victoria's Secret Stores and Direct. The Victoria's Secret Direct website is split into regular and clearance categories. The regular website carries 2100 styles totaling to about 42,000 SKUs and the clearance website carries between 500 to a 1000 styles at anytime totaling to about 20,000 SKUs (Limited Brands Interview, 2005). It is estimated that the largest customers for Victoria's Secret as a whole are multi-channel buyers. These are customers who shop from the catalogs and website, as well as stores. There is little overlap in the merchandise assortment between the Direct business and Victoria's Secret Stores, but it is speculated that the Direct channel drives many Victoria's Secret customer to its stores.

5.5.1 Demand Forecasting and Planning

On the demand planning and forecasting front, the Catalog and Web businesses are governed by separate strategies. This is primarily because the drivers of demand for the two channels are different. For the catalog, the demand forecast is mapped against the curve of the product life cycle from the point the catalog is mailed to when 98% of the product is sold. Moreover, circulation of printed books is the primary driver of sales. Within a catalog, dynamics related to location of the display of product, and to the model selected for the display, are sales drivers. Once Direct has visibility as to the actual product layout of the catalog, it re-forecasts the demand several weeks before it is mailed, and subsequently adjusts its purchase orders.

For the web, on the other hand, the forecast is based on individual item performance on an hourly, daily or weekly basis. One of the key metrics that Direct uses to monitor its sales is given by the Net-Growth Ratio. This ratio measures for every $1 of demand generated, how much was generated for sales after accounting for returns, cancellations and failure to fulfill back-orders.

Victoria's Secret Direct, especially the catalog business, has additional levers in the way that they can offer a wider breadth of fashion assortments. This is because the marginal costs of carrying fashion versus basics product in Direct is governed by different dynamics in comparison to stores -- as the stores have huge fixed costs due to real-estate. Moreover, it is possible for Direct to leverage assets between the catalog and web operations such as common photography. About 400 million catalogs are mailed in a year; approximately one fresh book a week having anywhere between 60 to180 pages and including between 250 and 600 items. About 95-98% of the Direct products are sold in US. Semi-annual sales are tied together with Victoria's Secret Stores and a sale period is comprised of 8 weeks, requiring approximately 8 mailings during this time (Limited Brands Interview, 2005). Last, but not the least, if a product doesn't perform well in one media, it is not introduced in the other.

5.5.2 Sourcing and Production

Victoria's Secret Direct utilizes the Mast network, as do the Victoria's Secret Stores. Direct is able to maintain accurate data about customer preferences and buying patterns due to the online nature of its business. It is therefore able to quickly translate this information to its vendors, making it much more responsive to changing customer needs than the Victoria's Secret Stores. This allows Mast to adopt a sourcing strategy based on the vendors' ability to deliver smaller and more frequent orders. Smaller orders mitigate risk of over-stocking and frequency allows the company to react closer to the demand and to get the right product out to market in time.

5.5.3 Distribution and Fulfillment

On the distribution front, Direct uses its own distribution center in Columbus, Ohio, separate from the Victoria's Secret Stores' distribution center. Both web and catalog share this DC. The process of picking in distribution centers is different from stores, as these products are picked as single items based on orders, whereas in the Victoria's Secret Stores' operations the products are picked and shipped in cases. The average time it takes to get to customers is about two days. The online business is well integrated to inventory systems at the DC level, but is not integrated with Victoria's Secret Stores. With only about 15-20% of overlap in SKUs between the stores and Direct, this is not an immediate need (Limited Brands Interview, 2005). Direct keeps a close watch on its inventory and maintains fairly accurate item levels as well as order level data. For example, the current percentage of service level that Direct operates shows an 88% in stock and 12% back-order at the item level. This level of data integrity allows Direct to be much more responsive than Victoria's Secret Stores and as a result allows them to make dynamic changes to order quantities, pre-packs and size-curves based on latest selling patterns. In contrast to placing large orders with Mast, as do Victoria's Secret Stores, Direct can thus place smaller and more frequent orders. Moreover, Direct doesn't require excess inventory for the purpose of its floor and window displays as do Victoria's Secret Stores.

5.5.4 Goals and Challenges

As a part of the INSIGHT project, Victoria's Secret Direct is working closely with its production team to create a library of fabrics and raw materials to make a choice matrix such that lead times can be reduced dramatically. They are also a part of the same initiative to reduce concept-to-market lead times from 72 to 40 weeks.

One of the challenges that Direct faces in its online business is to notify its customers when products are in stock. On the catalog side, the challenge is severe, as Direct is often faced with demands from its customers who order styles from an older catalog which are currently out of stock. The other serious challenge for the company is in the area of returns. Currently, returns amount to approximately 25% of demand and are primarily driven by the Swim and Apparel categories; however a considerable part of returns are put back in stock. These are products which are in reasonable condition to be resold. The return rate for lingerie is negligible.

One of the challenges that Victoria's Secret faces overall is in the category of fringe sizes. Fringe sizes are the ones which are on the tail-end of the demand curve and whose demand patterns are harder to predict. Customers looking to buy these sizes typically feel the need to try them on before purchase. If these products are carried by Direct, there is potential for reduced customer service levels. On the other hand, if Victoria's Secret Stores decides to carry these sizes to provide better customer service, they will be faced with challenges of less predictable demand patterns for these sizes, leading to over or under stocking of product. Therefore, the company has to work a delicate tradeoff between providing better customer service levels and the subsequent financial impact of this service.

A survey about multi-channel retailing tactics used by retailers, conducted by Forrester research, showed that 87% of retailers allowed purchases made online to be returned to stores (see Figure 16). Limited Brands aspires to integrate Victoria's Secret with its Direct business. This may involve large logistical challenges for the brand but may have a positive impact of customer satisfaction levels as the customers will be able to return goods purchased online to Victoria's Secret Stores, and may even be able to pick up products in stores which they purchased online. Limited Brands aspires to make its other brands Direct-capable as well.

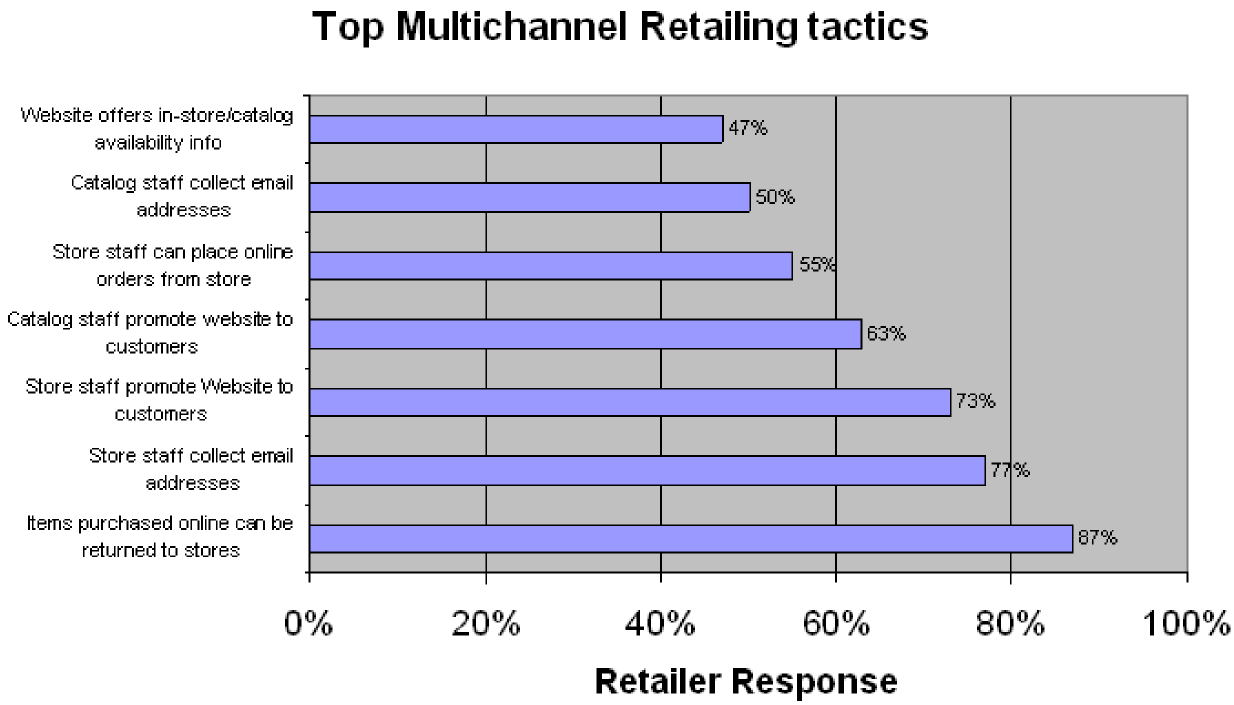


Figure 16

Modified from a shop.org survey conducted by Forrester Research
Source: "The state of retailing online 7.0"

6 Victoria's Secret's Supply Chain Framework

Victoria's Secret's business strategy has evolved from a shop-and-copy system to a branded concept, that of selling innovative, technologically advanced products at reasonably high profit margins. The Victoria's Secret brand is positioned to be the dominant, young, sexy and sophisticated lingerie and beauty concept, targeting young customers who appreciate the value of possessing innovative lingerie. At the same time, the company is somewhat risk averse. It does not rely solely on its fashionable bra launches for all of its sales. It distributes risk by having a mixed assortment of fashion and basic goods. However, having this mixed assortment adds complexity, in that the brand has to operate two supply chains; one for each of these types of products. This chapter introduces the underlying operating model, operational objectives and important tailored business activities that drive sustained competitive advantage within the Victoria's Secret supply chain (see chapter 1 for framework) and align with the overarching business strategy.

Zara, a Spanish retailer of fashion goods, has recently garnered a lot of attention for its supply chain prowess. Zara's business strategy is to target customers who want fashionable but cheap clothing. Both of these business strategies are successful and require a customized set of supply chain operations aligned to their individual needs. This chapter briefly addresses these supply chain strategies which are crucial to the success of each of the two retailers but may or may not be applicable to the needs of the other firm.

6.1 Complementary Operating Model

The operating model at Victoria's Secret Stores is to achieve desired brand recognition through innovative product development, glamorous bra launches and high shelf availability of its products. Most of the Victoria's Secret Stores' new product introductions are offered in both fashion (items with less predictable demand) as well as basic (stable demand) styles. This mix of fashion and basic items helps Victoria's Secret to distribute risk, to ensure profitability and to offer compelling value to customers. The company identifies that there is not a single all-in-one supply chain solution for both of these categories of products and therefore it maintains two different types of supply chains for each.

The supply chain for Victoria's Secret's fashion items is driven by "Speed-to-Market" to ensure responsiveness. This is reflected in the company-wide initiative to shorten its "Concept-to-Market" calendar. This supply chain is further governed by a sourcing strategy that requires a set of suppliers with an excellent record of product innovation, value-adding capabilities and no minimum volume requirements. Due to the prioritization of speed over low labor cost, these items are made in the most capable factories in the world, wherever they may be, and are consistently air shipped to the company's distribution center in Columbus, Ohio.

On the other hand, the supply chain for Victoria's Secrets basic items is driven by factors like asset utilization and supply chain efficiency. As a result, basic goods are manufactured in vertically integrated factories which provide close control over capacity utilization and productivity. These factories run at full capacity and provide economies of scale (Limited Brands

Interview, 2005). Mast holdings has an equity stake in two of Limited Brands' largest factories in India and Sri Lanka. This is a strategic decision in order to maintain tighter control and better supply chain visibility.

6.2 Operational Objectives

With the help of Limited Logistics Services (LLS), Victoria's Secret has drafted a Service Level Agreement that defines various performance metrics for services to Victoria's Secret Stores. This agreement also defines the role of the Victoria's Secret Stores in successfully meeting these objectives. The performance metrics are divided into three broad categories as defined below.

6.2.1 Customer Response

These metrics are customer-focused and customer-facing. They include a set of distribution metrics as well metrics related to store performance such as Responsiveness, Floor-Set, Business Priorities, New Stores, Value Added Services (VAS), Meeting Cadence, Reporting, and Air Shipments.

6.2.2 Efficiency

These are internal metrics. They are productivity and cost-related and include a set of metrics at the manufacturing as well as distribution center level such as Auditing/Cycle Counts, Through-Put, Network Productivity, DC Metrics, DC Throughput, and Store Throughput.

6.2.3 Asset Utilization

These metrics are also internal-facing and largely focus on maintaining economies of scale. They include: Capacity Utilization and Inventory Turns.

6.3 Objectives Balancing Framework

The focus placed on each of the metrics mentioned in 6.2 varies by whether the product is basic or fashion. For example, in the category of basic products, asset utilization metrics like capacity utilization and efficiency objectives like supply chain costs and productivity carry more weight than responsiveness. The factories making these products run at full capacity with two shifts per day to efficiently deliver these products to market at minimum possible cost of production. These products generate moderate margins for the company in comparison to the fashion products. On the other hand, in high-margin product categories of fashion goods, particularly in highly promoted launch-related fashion goods, which are most often a result of innovative product development and have relatively short-product-lifecycle of just one season, responsiveness metrics are seen to carry more weight overall. The focus in this model is to increase in-season product availability to reduce lost sales and maximize margins. Figure 18 illustrates the focus on the metrics that the company places for basic items. The shaded portion implies in that this model is heavily skewed toward efficiency and asset utilization metrics. Figure 19, illustrates the focus on the metrics that the company places for fashion related items. The shaded portion, in this figure, implies that this model is heavily skewed toward customer-response.

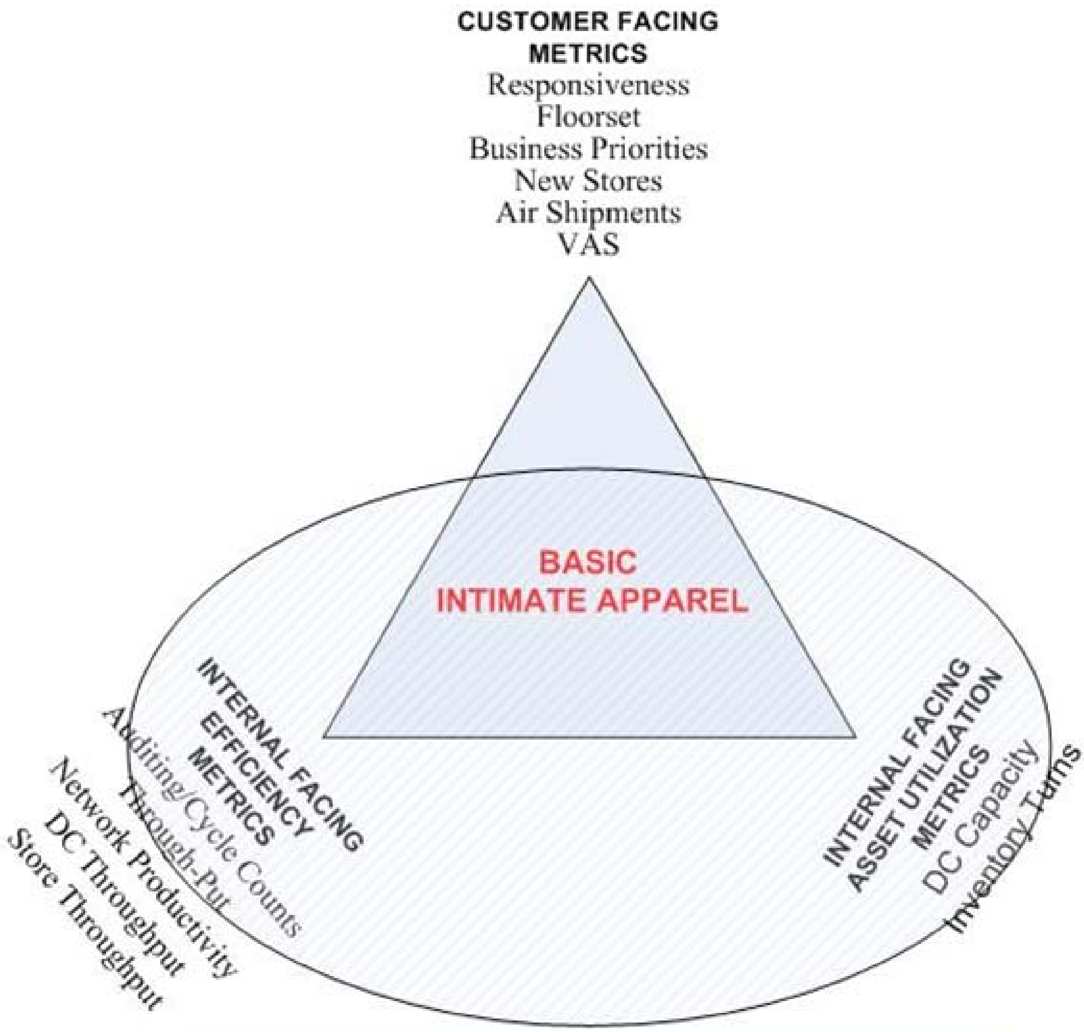


Figure 17 Objectives Balancing Framework for Basic Items
Shaded portion depicts the importance of
Efficiency and Asset Utilization metrics

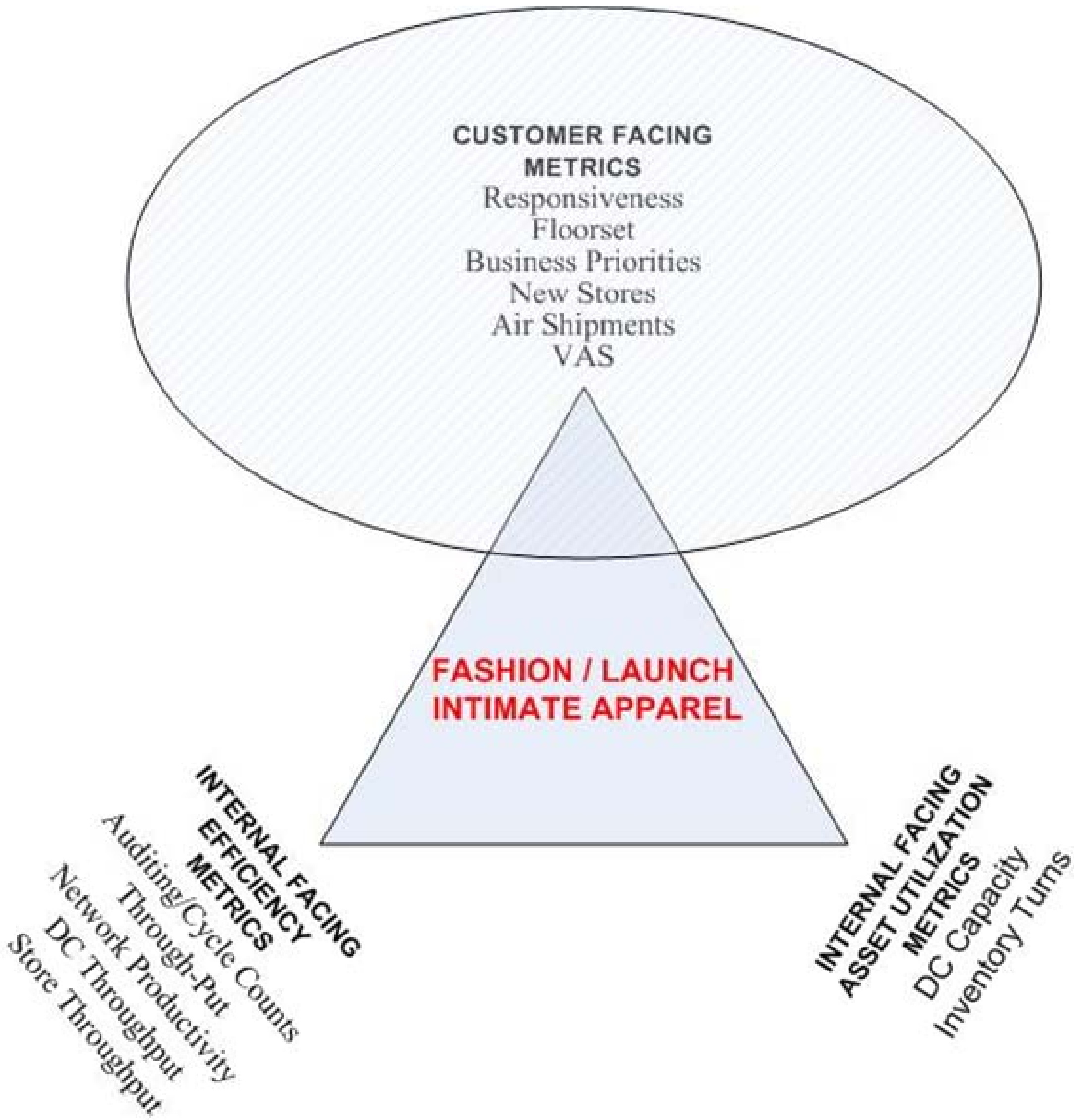


Figure 18 Objectives Balancing Framework for Fashion Items
Shaded portion depicts the importance of
Customer Response metrics

6.4 Tailored Business Activities

At the operational level, there are a set of three tailored business activities that provide significant competitive advantage to the Victoria's Secret supply chain and place Victoria's Secret in a unique position in comparison to its competitors. These activities are aligned to the overarching strategy, which is to deliver an assortment of innovative fashion products and less-risky basic products.

The first tailored activity emanates from the company-wide open innovation model. The de-centralized design culture within Victoria's Secret adds unique capabilities to its supply chain design. Product Innovation can come from the supplier, from in-house development or through design inspirations from external concepts. This creates the possibility of inter-company operating ties with outside suppliers. For example, if Limited Design Studios in New York initiates a design concept, it can go to a preferred supplier to be further developed and even changed. This relationship during the design process adds flexibility, which is hard to replicate.

The second tailored activity has to do with the sourcing model that Limited has adopted as a whole. The presence of Mast Industries as a wholly-owned subsidiary of Limited Brands is of tremendous value to the company. Mast carefully selects its vendors based on capabilities to manufacture and deliver fashion versus basic products. Mast works with a set of vertically integrated factories as well as raw material suppliers to create a product that is hard to replicate. For example, in the case of the IPEX® product development, Mast worked with raw material suppliers who were experts on foam manufacturing for a leading automotive manufacturer to create a padded bra which is incredibly light and comfortable. The light weight of the product also makes it a good candidate for air-shipping at lower cost per unit.

Vertical integration helps the company to control the production process from fiber to garment. On one hand, this leads to greater manufacturing efficiency required for producing basic products, which generate relatively lesser profit margins than fashion items. On the other hand, vertical integration also helps to speed the product development process essential for new and fashionable products.

Finally, the role of Limited Logistics Services' (LLS) "shared service model" in the smooth operation of its supply chain is indispensable. As mentioned earlier, the Service Level Agreement with each of its brands, including Victoria's Secret, not only defines the detailed performance metrics but also defines the role of the each brand in order to carry out the objectives on time. LLS consistently benchmarks itself against outside logistics providers and has been able to provide higher service levels to its brands at competitive costs. The dynamic ability of LLS to constantly evaluate and re-evaluate its performance against external agencies helps Victoria's Secret to stay ahead of the competition. In its logistics design, LLS incorporates the fact that whether a product being delivered is fashion or basic. For example, in most cases, fashion lingerie is air-shipped from Asia to Columbus, OH and basic products are ocean-shipped. This is because the fashion products, which have relatively higher margins, are less price-sensitive to transportation costs per unit. Fashion and launch products may also have to go through a customized value-added service process in order to cater to the requirements of the individual stores to which they are shipped. These value-added services are performed at the DC level and the company claims to perform them more cost effectively and efficiently than an outside third party logistics provider.

6.5 Contrasting Victoria’s Secret with Zara

Zara’s supply chain capabilities have been much discussed, particularly, Zara’s ability to be “super-responsive” (Ferdows et al, 2004) and to develop marketable products from concept to shelf at speeds which are unmatched by its competitors. However, it is important to be mindful that supply chain operations of any kind are only subsets of the overarching business strategy and should not be evaluated in isolation.

There are interesting contrasts between the Victoria’s Secret supply chain and the supply chain of Zara. Zara’s strategy is to target customers who want fashionable but cheap clothing and Victoria’s Secret, on the other hand, is looking to “trade up” while maintaining a distinct brand image. According to an industry observer, Zara’s clothing has a premier look, as they are often copies from top designers. This resembles the shop-and-copy strategy that Limited Brands adopted prior to the early nineties.

We first address a few important areas of comparison between the two companies and then attempt to identify if there are any supply chain strategies that have been successful for Zara that may be applied at Victoria’s Secret and vice-versa.

6.5.1 High Shelf Availability versus Scarcity

Zara treats its clothes as perishable goods. On the first day, its clothing may attract tremendous customer attention, or in industry terminology “hanger-appeal”; on the second and third day it may begin to lose the initial appeal, and on the fourth day, if inventory still remains unsold the company will heavily mark it down just to clear up space. Zara still ends up marking down only 18% of its products at the end (Dutta, 2002). This model is in contrast to that of Victoria’s Secret as VS goes on sale only two times a year and rarely marks down its products in stores. Scarcity, in the case of Zara, drives sales, but in case of Victoria's Secret may lead to lost-sales, as availability is a key driver of sales for both basic and fashion items.

6.5.2 Fashion versus Basic

VSS is somewhat risk averse, which implies that when there is an opportunity to fill a volume void to reach certain stock levels within a sub-brand, it is more likely that a basic product would be chosen over a fashion product. As Victoria's Secret's business has a large replenishment element, the planning team often constrains its fashion buys to support the replenishment business. This hurts VS on fashion products, as they risk experiencing regular stock-outs. This is in contrast to the regular apparel business like Express® where inventories completely turn between 12-16 week periods (Limited Brands Interview, 2005). Zara, on the other hand, completely relies on smaller quantities of risky fashion items, using scarcity to generate sales.

6.5.3 Concept to Market (Lead-Times)

A key difference between the design strategies of the two companies is that while Victoria's Secret sets the trends, Zara reacts to trends in the market place. Zara can thus move from identifying a trend in the market to on-shelf deliveries within 30 days (Dutta, 2002). In case of Victoria's Secret, the current launch cycle takes up to 76 weeks with the aspiration to be under 40 weeks (Limited Brands Interview, 2005). However, VS is creating demand through innovative design, where Zara does not have such capability.

6.5.4 Proximity to Customer

Victoria's Secret sources production from its low-cost overseas factories in the Far East. It then airships all of its fashion goods to its local distribution center in the U.S. and is still able to derive margin out of its products. This is primarily because the fashion goods are light weight and have high dollar value. Zara, on the other hand, manufactures 80% of its goods in Europe, much of it within a small radius of its headquarters in Spain (Dutta, 2002), which historically has had some of the lowest wage rates in Europe. Zara's success thus may be heavily reliant on particular local characteristics, and may not translate to global markets.

6.5.5 SKU proliferation

Zara introduces about 12,000, mostly non-repeatable styles per year in various colors and sizes (Dutta, 2002). Victoria's Secret, on the other hand has a total of 12,000 SKUs including different sizes and colors and does about 70 new product introductions in one year (Limited Brands Interview, 2005). Again, this difference is primarily driven by the fact that Zara does not create these designs, but instead copies high-end fashions.

6.5.6 Conclusion

Victoria's Secret and Zara operate based on different business strategies, which are well suited to their individual needs and geographical locations. Both strategies are supported by specific supply chain operations which work well for their needs.

As noted earlier, VS heavily relies on a technologically advanced and innovative product development process. So, for a faster concept-to-market cycle, Victoria's Secret may have to reduce its product design complexity, something it may not be willing to compromise on from a strategic perspective. The IPEX® bra, for example, has been marketed as an advanced piece of construction and product complexity in this case adds a unique competitive advantage. Zara, on the other hand, still works on a shop-and-copy model and produces fashionable products which do not go through elaborate design development processes. This brings the required speed to its supply chain.

Another interesting aspect to note in the case of Zara is how its current operating model of producing closer to the customer demand may work for Zara's international business. Zara's clothing may not be able to generate premium margins because of its relatively cheap to moderate pricing structure. As a result, air-shipping all of its goods, which are essentially all fashion items with a short shelf-life, from Asia or Spain to its North-American and other international store locations, may not be as profitable for the company. In addition, the process of manufacturing in the United States and being closer to customer demand will likely involve higher labor costs in comparison to Spain or Asia.

VS and Zara's business strategies have their own blends of success elements. In order to capture best practices from one other, each of the companies will have to create conditions that will enable them to fit into the same mould as the other, potentially compromising their individual strategies.

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List of Acronyms

A&F	Abercrombie & Fitch
AUR	Average Unit Retail
BLS	Bureau of Labor Statistics
CAGR	Compounded Annual Growth Rate
CEO	Chief Executive Officer
CFO	Chief Financial Officer
COGAFS	Cost of Goods Available for Sale
CPI	Consumer Price Index
DC	Distribution Center
EVP	Executive Vice President
FEDEX	Federal Express
GMM	General Merchandise Manager
H&M	Hennes & Mauritz
IT	Information Technology
KPI	Key Performance Indicator
LDS	Limited Design Studio
LLS	Limited Logistics Services
PO	Purchase Order
POS	Point-Of-Sale
SC2020	Supply Chain 2020

SIC	Standard Industrial Classification
SKU	Stock Keeping Unit
SLA	Service Level Agreement
SME	Small and Medium Enterprise
SS	Safety Stock
SVP	Senior Vice President
UPS	United Parcel Services
VAS	Value Added Service
VS	Victoria’s Secret
VSB	Victoria’s Secret Beauty
VSD	Victoria’s Secret Direct
VSP	Victoria’s Secret Production
VSS	Victoria’s Secret Stores