

**A Strategic Analysis of
An Active-wear Wholesale Distributor
In Canada**

By

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ABSTRACT

This paper presents a strategic analysis of a leading active-wear wholesale distributor in Canada (referred to in this report as SMC). In the past four years, SMC's sales have dropped substantially but SMC remained profitable. SMC faces challenges to attain sustainable growth.

This paper conducts industry, and SMC's value chain analysis. Key issues are identified to address the areas of growth, cost reduction, intelligence collection and technological improvement.

Recommendations are presented for SMC to update its strategies to address the pressing issues. It is recommended that SMC first review its growth strategies with product and market focuses. Next, SMC must continue to improve operational efficiencies to further reduce costs. Last, SMC should invest on information technologies to gain competitive advantages to further improve customer services. Supporting this, SMC should continue to focus on developing and retaining its people who will make this company towards future successes.

DEDICATION

This paper is dedicated to my parents who have always believed me that I can do better and become a better person. In the difficult times, dad and mom tried their best to support the family and to give me the best education. Dad and mom were also brave to support their youngest child to migrate to Canada to experience a different life. Without their love, I could not achieve this.

To my grandparents, who taught me my first word, and developed my interests to explore this world. The first eight years in my childhood with them were the fundamentals that have developed myself as who I am. I had so much fun and unforgettable memories with them. Their attitudes to challenging life will be my goal of lifetime learning.

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1. Products / Markets of the Firm

1.1 Overview of SMC

Privately founded in 1989, SMC is a wholesale distributor of imprintable active-wear in Canada. SMC serves 15,000 customers by offering 200 styles of the best selection of branded apparel, sport shirts, dress shirts, outerwear, T-shirts, fleece and more for men, women and children. Most of the customers are advertising specialties, embroiderers, screen printers and other types of wholesalers. SMC also sells products to a selected variety of retailers.

SMC has four shareholders. One of the shareholders also owns SMUS located in Seattle. The other two shareholders run SMC's operations. The company has four distribution centers located in Richmond, Mississauga, Halifax and Calgary. SMC's headquarters is in Richmond. SMC employs approximately 100 employees.

1.2 SMUS

Incorporated in 1971, SMUS is an award-winning supplier of more than 11 apparel brands, including exclusive distribution of PING® sportswear for the corporate identity market. SMUS also manufactures and distributes Port Authority®, Port & Company® and Sport-Tek™, highly respected private-label brands, solely for the imprintable sportswear industry.

SMUS's customers include screenprinters, embroiderers, promotional products distributors and athletic dealers. Customers count on SMUS for industry-leading service on products and marketing tools. Deep inventories and accuracy are SMUS's hallmarks, backed by:

- Over 400 styles on inventory
- 1.65 million square feet in warehousing space nationally
- 24 hour turn-around on all orders
- Companion Styles - The industry's largest selection of coordinating outfits for men, women and youth
- XS-6XL Sizing - Offering the right fit for every member of the team
- New Fabrics and Colors - Providing fresh, up-to-date styling

SMUS has six distribution centres located in Seattle, Washington; Cincinnati, Ohio; Reno, Nevada; Cranbury, New Jersey; Dallas, Texas and Jacksonville, Florida that allow SMUS to ship within 1 to 2 days to 99% of the continental U.S. population. With over 1.65 million square feet of distribution space, SMUS has the ability to provide fast and consistent service to its customers.

1.3 Business Philosophy¹

SMC business philosophy is based on four pillars: partnerships, service, growth and continual improvement.

Partnerships

All SMC's stakeholders, whether they are owners, managers, customers or suppliers are partners with SMC. They all work together to meet each others' needs and make improvements. As an employee that means SMC supports him / her in making his/her job as fulfilling as possible while he/she works with the company to serve customers better.

Service

SMC's business was built and thrives because of its commitment to provide excellent service to customers. SMC's priority is to make it as convenient as possible for

¹ SMC's employee handbook

customers to do business with SMC; everything else is secondary. SMC's customers do not deal with SMC because of pricing alone; they deal with SMC because of great service.

Growth

SMC is committed to growth, not only in the size of the company but also in the well being of its employees. SMC conducts peer reviews and performance appraisals so employees hear from their peers what they do well and learn how to improve in areas that may need work

Continual improvement

No matter how well something is being done it can be done better. Whether it is how SMC deals with customers, suppliers or each other, SMC can always improve. SMC encourages employees to look for opportunities to make suggestions or take action to do work more efficiently, improve service or reduce costs.

1.4 Mission statement and values

Mission statement

SMC's mission is to become the best Activewear distributor in Canada.

SMC is committed to:

- Consistently meeting the service expectations of its customers by responding to their needs.
- Providing a fair and challenging workplace through empowerment, positive reinforcement and the opportunity for growth that encourages excellent performance
- Continuously improving systems to enhance the efficiency and effectiveness of all aspects of business
- Continue successful managed growth and profitability
- Building strong and beneficial partnerships between ourselves and customers, suppliers, employees and shareholders.

Values

SMC's values are:

- Responsiveness to customers – “Our Action Starts As Soon As Our Customer Speaks”.
- Human Resources – family culture – “I’m Part Of The SMC Family”.
- Quality – “Quality First Is Second to None”.
- Fun – “We Whistle While We Work at SMC”.
- Expansion – “Here We Grow Again”.
- Image – “The World Is Watching”.
- Strategic Alliances – “Our Alliances Will Help Us Grow Together”.
- Profitability – “Profitability Will Allow Us To Be The Company We Want To Be”.

1.5 Focus of the Paper

The paper begins by providing an overview of the company’s product offerings along with information about its target markets. SMC’s participation in the industry value chain will be reviewed and its own value chain and strategic fit will be discussed. The key issues the company is facing will then be outlined and recommendations will be provided to address the challenges in later chapters.

1.6 Product offerings

SMC offers 10 categories of active-wear such as sports shirts, woven shirts, work-wear, outerwear, ladies’ wear, T-shirts, athletic wear, race wear, fleece, youth wear and bottoms. The sales of T-shirts represent 56% of SMC’s business. Table 1 illustrates the categories that are carried by SMC.




Table 1 2004 Sales by category

2004 Sales by Category	Percentage of total SALES in 2004
T-shirt	56%
FLEECE	16.8%
SPORT SHIRTS	13.9%
JACKETS & OUTERWEAR	8.2%
DRESS SHIRTS	3.5%
TANK TOPS	0.6%
SHORTS	0.5%
WORKWEAR	0.2%
CAPS	0.2%
TOWELS	0.1%

Data source: SMC’s internal reports

The following figure 1 illustrates the samples of product offerings.

Figure 1 Samples of product offerings

				
Basic T	Fleece	Outerwear/Jacket	Golf shirt	Long sleeve T
				
Sports shirt	Youth T	Lady's T	Fleece Vest	Dress shirt
				
Tank top	Workwear	Safety wear	Baseball T	Race wear
				
Sportswear	Pants	Leather Jacket	Tower	Premium sports shirt

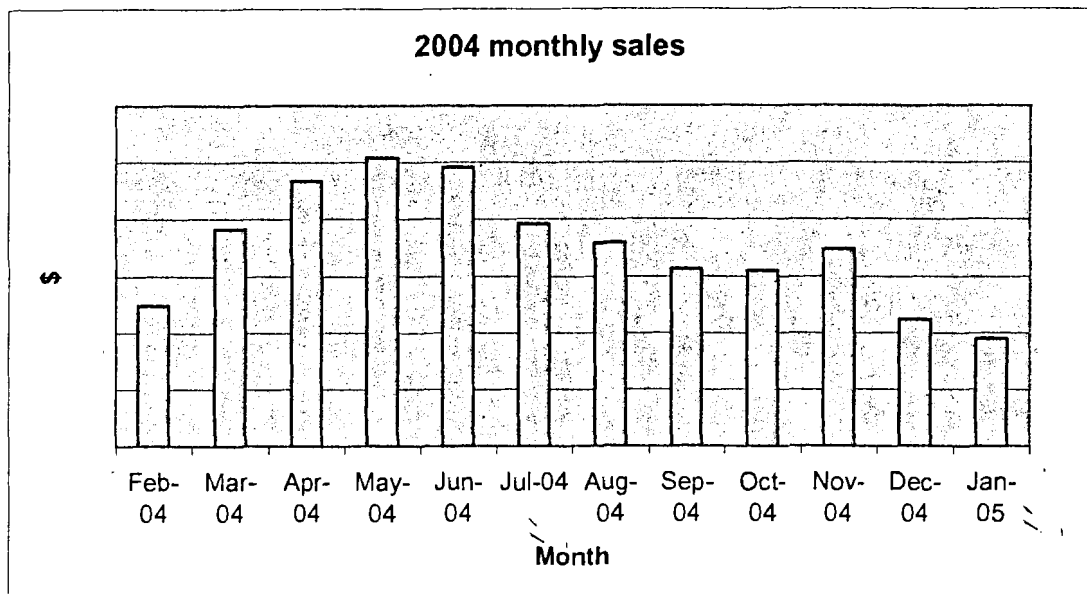
Source: SMC's product brochure, by permission

1.7 Target Markets

Being an active-wear distributor, SMC competes in a very competitive market. The market can be segmented into two groups. One segment is value-added partners consisting of advertising specialties, embroiderers and screen printers. The customers in this segment usually deal with events, such as sporting events, shows and exhibitions. The other segment is retailers consisting of chain stores such as Marks Works Warehouse.

The market is seasonal. SMC sells mostly T-shirts in summer, outerwear and fleece in winter, and the rest of the categories throughout the year. April, May, June and July are SMC's peak season. Sales then slow down in August, September and October. Sales go up again in November because customers build up inventory for the Christmas season. January and February are the slowest months. Figure 2 illustrates the seasonal sales trend in 2004.

Figure 2 2004 monthly sales



Data source: SMC's internal sales report

The market also varies geographically. Table 2 illustrates SMC's sales by Provinces in 2004.

Table 2 SMC Sales by top five Provinces in 2004

Sales by Provinces in 2004	Percentage of total Sales in 2004
ON	38.2%
BC	29.2%
AB	14.2%
NS	4.8%
QC	4.2%

Data source: SMC's internal sales report

The well-established markets in Ontario, BC and Alberta contribute 80% of SMC's revenue. In other words, 60% of Canadian total population contributes 80% of SMC's business. Figure 3 illustrates Canada's population by provinces.

Figure 3 Populations by Provinces as of Oct 1st, 2003



Data source: <http://www.statcan.ca/english/kits/winner/2003/grade8/population/population.htm>

As illustrated in Table 2 and Figure 3, SMC's sales by provinces are not in line with the population by provinces. That shows SMC is strong in the market where it has a distribution center and weak in the market where it does not. The root cause and opportunity for growth will be discussed in a later chapter.

1.8 Competition

SMC competes with other distributors directly by offering homogeneous products. The winning strategy relies on price, stock availability, convenience and, most importantly, service. Every year, SMC competes against GTS² for the Vancouver Sun Run T-shirt order. A few cents difference in price will win a 50,000 t-shirts' order.

Competition not only drives the price down, but also diversifies the range of products. The competition is the main force driving improvements in customer services. Customers are becoming sophisticated and any single product offering cannot satisfy their needs. Customers expect to purchase goods at one-stop-shops.

² GTS is a regional wholesale distributor based in Vancouver and has warehouse in Calgary.

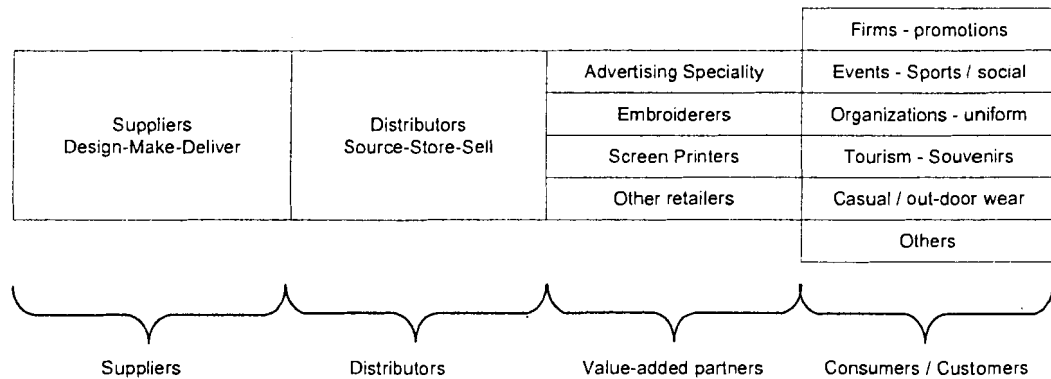
2 Industry Analysis

This chapter presents an analysis of the competitive forces affecting Canadian imprintable active-wear industry by using Porter's model of five basic forces³.

2.1 Imprintable active-wear industry overview

The Canadian imprintable active-wear industry is defined in the following figure.

Figure 4 Imprintable Active-wear Industries



The industry comprises four segments in the value chain.

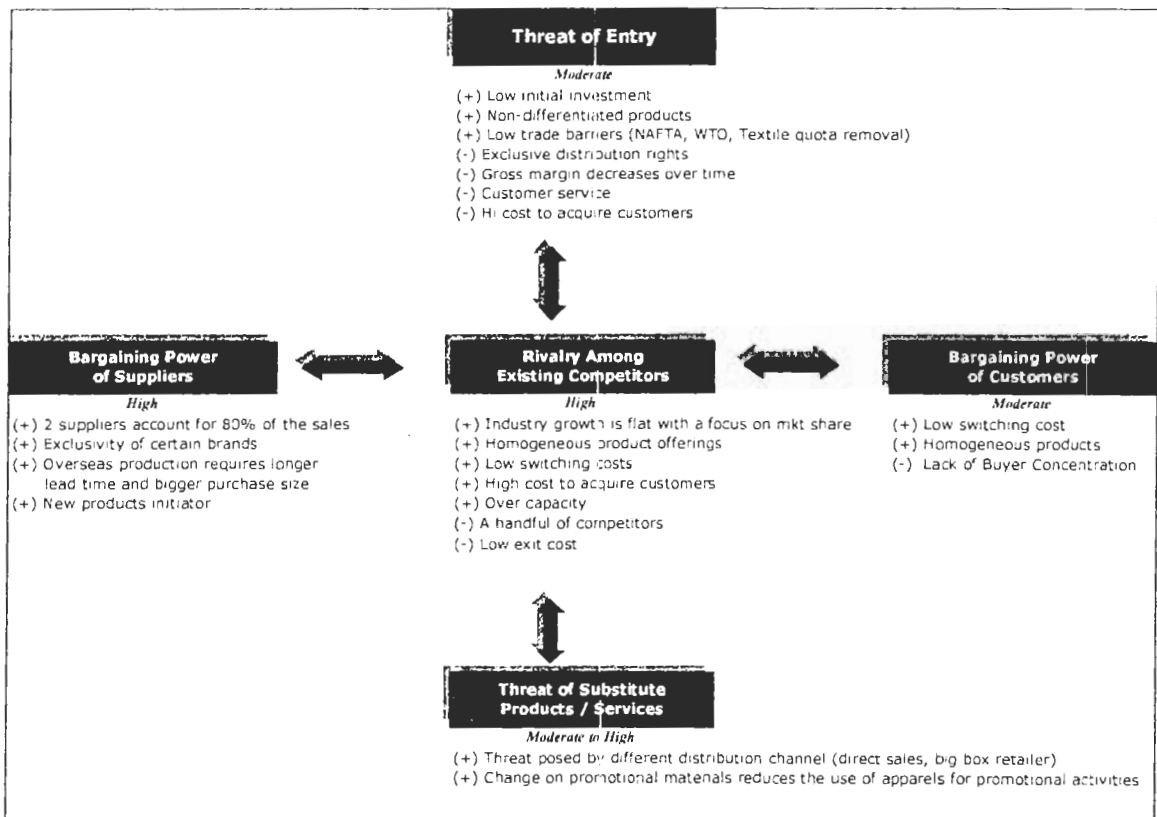
The suppliers design, make and deliver the apparel to distributors. The distributors source, store and sell the apparel to value-added partners. The value-added partners embroider or print artwork and sell them to customers. The customers or retailers get the final apparel sell them to final consumers who could be event participants, employees or tourists.

³ Porter, Michael E. How Competitive Forces Shape Strategy. Harvard Business Review: March-April, 1979

2.2 Five Factor Analysis of Imprintable Active-wear Industry

The following Figure 5 presents an analysis of the competitive forces affecting active-wear distribution industry using Porter's model of five basic forces.

Figure 5 Five factors map



Based on: Porter, 1979

2.2.1 Bargaining Power of Suppliers

The bargaining power of suppliers in this industry is high.

The supply to the industry is concentrated in a few powerful suppliers. For SMC, Gildan⁴ supplied T-shirts and sports shirts accounted for 60% of SMC's revenue in 2004. Gildan also has a 35% T-shirt market share in the US and 50% in Canada. It has

⁴ Gildan Activewear Inc: Based in Montreal, Gildan Activewear Inc is dedicated to being the global low-cost manufacturer of quality basic knit apparel for North American and international markets.

tremendous power in terms of setting the quality standard, supply and the retail price. The top two suppliers alone contributed 70% of SMC's revenue in 2004.

Table 3 SMC's sales by vendors in 2004

SMC's SALES BY VENDORS	PERCENTAGE OF TOTAL SALES IN 2004
VENDOR A	60.4%
VENDOR B	6.8%
VENDOR C	5.2%
VENDOR D	5.1%
VENDOR E	3.5%
VENDOR F	2.6%
VENDOR G	2.3%
VENDOR H	2.2%
VENDOR I	1.8%
VENDOR J	1.4%
VENDOR K	1.2%
VENDOR L	1.2%
VENDOR M	1.2%
VENDOR N	1.1%
VENDOR O	0.9%
VENDOR P	0.8%
VENDOR Q	0.5%

Data source: SMC's internal sales report

Table 3 shows that the top five suppliers contributed 80% of SMC's sales in 2004. And the power of these suppliers is increasing.

Some suppliers have specific requirements for distributors. PING®, a premium brand of golf apparel, does not allow its products to be distributed or sold to stores which sell alcohol or cigarettes, to maintain its healthy brand image. In order to keep exclusive distribution rights, SMC has to purchase a large quantity and wait for six months to get products from PING's offshore production facilities, as well as comply with their specific requirements. The wholesale and retail prices are also decided jointly with PING®.

Suppliers' power increases when suppliers move their production offshore. In order to reduce manufacturing cost, most of the suppliers move their production to

Central America and Asia. Such shifts require distributors to commit to long lead-time and large purchase size. Distributors are also locked in within the purchasing lead-time. Suppliers give distributors very little flexibility to modify purchase orders, especially for the seasonal products. But for the non-perishable products, distributors still can sell the goods for the same season next year but have to compromise by keeping a higher inventory level. On one hand, such a large committed purchasing quantity smoothes suppliers' production, thus the cost of product is reduced. On the other hand, being locked in by a large purchasing quantity and long lead-time; distributors are less flexible to meet the changes in the market.

Suppliers also design and develop new products. Suppliers' major control on new product development increases their power. This industry organizes trade shows to demonstrate new styles, designs, materials, colors and fashion trends. The trade show usually gathers apparel designers, raw material suppliers and manufacturers to showcase future trends. SMC attends the shows to identify trends in the market and develop its own catalogue to serve customers. The suppliers' proactive role in product development increases their power. Instead of participating in new product design and development, distributors select from a variety of new products offered by suppliers.

In this industry, suppliers push products to the market and drive the market. In general, suppliers provide many designs and styles that are usually more than enough for distributors to choose, to meet market demands.

2.2.2 Bargaining Power of Buyers

The bargaining power of buyers is moderate.

With low switching cost, buyers have tremendous power to bargain for the best deal. Customers usually shop around and compare price, stock availability and service. They can buy from any of the distributors that provide the best deal. For big events, such as the Vancouver SunRun, negotiations start months ahead of schedule.

Buying homogeneous products enables buyers to switch or shop around easily from one distributor to another. Table 4 illustrates SMC's top 20 customers in 2003.

Table 4 SMC's top 20 customers by sales in 2003

TOP 20 CUSTOMERS BY SALES IN 2003	PERCENTAGE OF TOTAL SALES IN 2003
CUSTOMER A	2.4%
CUSTOMER B	0.9%
CUSTOMER C	0.6%
CUSTOMER D	0.6%
CUSTOMER E	0.6%
CUSTOMER F	0.6%
CUSTOMER G	0.6%
CUSTOMER H	0.6%
CUSTOMER I	0.6%
CUSTOMER J	0.5%
CUSTOMER K	0.5%
CUSTOMER L	0.5%
CUSTOMER M	0.5%
CUSTOMER N	0.5%
CUSTOMER O	0.5%
CUSTOMER P	0.5%
CUSTOMER Q	0.5%
CUSTOMER R	0.5%
CUSTOMER S	0.4%
CUSTOMER T	0.4%

Data source: SMC's internal reports

Lack of buyer concentration reduces buyer's power. Switching by individual customer has minimal impact on SMC's business. Most buyers are "mom-and-pop" stores that have neither big geographical coverage nor purchasing power. There are some exceptions such as Mark's Work Warehouse which consolidates its purchases and distributes them to its hundreds of chain stores nationally. This gives Mark's Work

Warehouse strong buyer power that allows it to get better pricing. The rest of the buyers do not have any advantage on pricing. As illustrated in Table 4, among the top 20 customers by sales in 2003, only one customer contributed more than 1% of total SMC's revenue. Customer A is a top brewery company and used to be SMC's big customers. Those brewery companies had tremendous buyer power at that time. Since 2004, those brewery companies have changed their promotion methods and materials. T-shirts are no longer their popular promotional material. Therefore, no single company or chain store contributes more than 1% of sales to SMC's business. The bargaining power of buyers has reduced over time.

2.2.3 Threat of Substitute Products

The threat of substitute products is moderate to high.

The threat posed by different distribution channels increases the substitute products. Some suppliers offer direct product order that eliminates distributors from the value chain. Hanes⁵ offers "Design your own shirts" on its website that allows customers to design and customize their own T-shirts and have them delivered directly from Hanes. ECommerce has eliminated the boundary of doing business in this industry. It is possible for single big event organizers to order T-shirts directly from Gildan, for example, the Vancouver SunRun. As such, the distributor is eliminated from the supply chain. Furthermore, big box retailers, such as Wal-mart and Costco, offer some of the homogeneous products at competitive prices. Customers can often get bigger discounts from Wal-mart than through the traditional distribution channels.

Firms use more diversified promotional materials to promote their products. Customer A was once SMC's biggest customer that purchased over a million T-shirts

⁵ Hanes Imprintable is an apparel division of Sara Lee and 2nd biggest supplier to SMC.

every year. For years, customer A used the promotion of “buy-one-case-of-beer-get-one-T-shirt-free”. Since it changed its promotion methods and stopped giving T-shirts away, SMC lost millions of dollars of T-shirt orders. Even though the T-shirt is no doubt the most popular promotional product, firms have many other substitutes to choose from to promote their products or services.

2.2.4 Rivalry among Existing Competitors

The rivalry among existing competitors is high.

The flat growth of the industry increases rivalry. The key players in the industry compete by stealing customers from others. There are three groups of customers: the organizers of sporting events, corporate consumers like Telus who require uniform or other dress shirts, and tourists who buy shirts as souvenirs. The overall industry is growing very slowly which does not give much room for profitable growth for companies.

Concentration of key players reduces rivalry. SMC is estimated to have 20-25% of market share. The top three companies compete nationally and have over 50% market share. Regional and local distributors share the remaining market.

Key players compete in four categories. They are T-shirt, fleece, sports shirts and jackets. All these distributors carry similar types of T-shirts made by Gildan, the biggest T-shirt manufacturer in North America. Firms compete on pricing, stock availability and customer service. Offering homogeneous products increases the rivalry.

Low exit cost decreases rivalry. The distribution business is easy to liquidate. The major parts of the assets are accounts receivable and inventory. The customer database is

the most valuable and intangible asset to the company. For SMC, the database includes 15,000 customers with basic contact information and sales history.

High cost to acquire customers increases rivalry because the majority of the customers are small that do business relying on relationships. Most of the big customers are centralized in urban areas where it is convenient to be visited. But it is difficult to visit small customers that are located in rural areas. Therefore, keeping remote or virtual contact with customers becomes critical to retain customers. Such contact requires investment in technology, especially in computer and telecom systems.

2.2.5 Threat of New Entrants

The threat of new entrants is moderate.

Low initial investment increases the threat of entry. A minimal capital investment is required to get into the market. New entrants only need to rent offices and warehouse space, hire and train people and install computer systems to start the business.

Non-differentiated products increase the threat of entry. There is minimal knowledge and skill required to distribute the products. The homogenous products are well accepted by the customers and the markets.

Low trade barriers increases the threat of entry. With NAFTA, WTO and the eventual textile quota removal for China, the products are widely available anywhere in the low cost production countries, primarily in Central America and South East Asia. American distributors are also considering entering into the Canadian market, as a means for growth.

Exclusive distribution decreases the threat of entry. SMC has the sole right to distribute the PING's® apparel in Canada.

Low and decreasing gross margin reduces the threat of entry. The industry becomes less attractive for those investors who are looking for high ROI. And some small players withdrew from the market due to decreasing gross margin.

Providing consistent and superior customer service decreases the threat of entry. This is the most important factor to maintain the company's competitiveness and survival in the market. It requires a firm to organize its primary and supporting activities efficiently to provide superior services to customers. Any failure or inefficiency in the value chain will result in poor services, thus, less competitive in the market.

High cost to acquire customers decreases the threat of entry. The lengthy and expensive acquiring process becomes the biggest challenge for new entrants. Most likely, new entrants have to "steal" customers from existing distributors.

2.3 Attractiveness of the Industry

The current state of the industry is characterized as "unattractive" for firms in the industry. Homogeneous product offering increases the rivalry and reduces the barrier of entry. In addition, the bargaining power of suppliers reduces distributors' autonomy in terms of setting flexible prices and introducing new products into the market. Thus, distributors work in a "reactive" mode to push the products into the market. Customers always try to get the lowest price possible. The changing demand creates more substitutes. The trend of moving production overseas requires the distributor to commit to longer purchasing lead-time and larger purchasing size. This increases distributors' inventory levels and reduces the flexibility to adjust product strategies when the market changes. The "source to order" model is impossible to implement due to loose or no possible

vertical integration with suppliers. Finally, it is a low gross margin industry in which firms struggle for profit.

2.4 Key success factors of the industry

In order to be successful in this industry, firms should possess the following factors.

First, firms must have a wide range of products with a reasonably high inventory level to avoid stocking out of popular items. Product selection is critical since customers only buy the products they want. Wrong product selection results in low sales and a high inventory level. Firms need to evaluate much information from multiple channels to select the right products. PPAC, Promotional Products Association of Canada, offers some information about the promotional products, including soft goods and hard goods, across the country. Firms also need to study its sales performance by products and territories. Also, the market is seasonal. If the products are not stocked enough before entering into the season, the sales target will most likely be missed. If the products are stocked too much, the stock will have to be kept for one year till the next season. If missing the combination of products and inventory, customers will likely buy products from a competitor who can fill the orders. Customers always shop around. It is critical for a distributor to get their business if orders can be filled right the first time. Providing “one-stop-shop” is the goal that most of the distributors want to achieve.

Second, beyond selling products, the firms must provide excellent customer service and maintain good customer relationships. Firms provide more than just products. It is the superior service, good customer relationships and shopping experiences that retain customers. A consistent order processing time is fundamental to providing

excellent customer service. SMC constantly keeps its promise that any order placed before 3:00pm will be shipped the same day and will be delivered within 3 days depending on where customers are located. So speed of delivery is part of service. Recently, one customer switched from SMC's competitor and complimented SMC on its great service in order processing. The customer stated its own experience of placing an order with a competitor on Monday that was not shipped until Friday. There was no reason not to switch to SMC. Just meeting customers' expectations and getting the orders out of the door are not enough. Firms need to go one step further to make it easier for customers to sell the products. In the industry, only SMC has developed effective sales tools that help customers promote and sell SMC's products at a very low cost. Customers can use sales tools, such as generic product catalogues and high-resolution product images, to effectively promote the products to their customers. As such, customers will likely come back to continue to buy from SMC.

Third, the firms must streamline their processes in order to operate the business efficiently. The market is very price sensitive. Any penny saved on the operations will allow firms to sell products at a lower price, and therefore, win the sales. In 2004, SMC won the Vancouver SunRun order by offering their T-shirts 5 cents cheaper than a competitor who did not sacrifice its gross margin. The overall gross margin performance has been improving. How could SMC achieve this? The initiative of CPI, continuous process improvement, re-engineered the order processing procedures to improve the efficiency by changing the processes and introducing new technologies. That resulted in lower cost per order and quicker order fulfillment.

3 Internal Analysis

This chapter conducts internal analysis of SMC to identify its generic strategy. Its strategic fit is discussed in details by analyzing nine factors based on Buskzar's model. As well as an analysis of its value chain is conducted based on Porter's concept.

3.1 SMC's generic strategy

SMC operates on a cost-based strategy.

Table 5 SMC's strategic fit

	Cost Based Low Cost/Adequate Quality					Differentiation High Quality/Adequate Cost	
		1	2	3	4	5	
Product Strategy	Rapid Follower		X				Innovative
R&D Expenses	Low R&D	X					High R&D
Structure	Centralized	X					Decentralized
Decision Making	Less Autonomy	X					Autonomy
Manufacturing	Economics of Scale	X					Economics of Scope/Flexible
Labour	Mass Production		X				Highly Skilled/Flexible
Marketing	Comparative/Push		X				High Cost/Pioneering/Pull
Risk Profile	Low-Risk		X				High-Risk
Capital Structure	Leveraged	X					Conservative

Based on: Bukszar, 2005

3.1.1 Product Strategy

SMC's product strategy is to source low cost generic products to provide fast and consistent services to customers. Competitors also sell similarly homogeneous products. For some brands or styles, SMC gets the exclusive distribution rights that differentiate SMC from competitors. But the exclusivity is subject to renewal on a regular basis.

SMC carries 10 categories of apparel that include sports shirts, woven shirts, work wear, outerwear, ladies' wear, T-shirts, athletic wear, race wear, fleece, and bottoms. The consumer who buys T-shirts from retail shops might recognize the brand but does not know which wholesaler distributes them. The key drivers for customers to buy are pricing, inventory availability and customer service.

By attending annual industrial trade shows and working with suppliers, SMC introduces 10%-15% new styles to refresh its product lines reflecting the latest industrial trends. As well, it discontinues a similar percentage of existing styles that become closeout items. Rarely, SMC works with suppliers and designers to design new clothing. SMC obtains most of its trend information regarding popular colors, and styles for the next season from tradeshow.

Product selection is an important part of SMC's business. SMC's planning cycle takes place on a yearly basis. Every year, the product selection begins as early as April. The process is initiated by the purchasing department and is supported by the marketing and sales departments. Suppliers show their new design clothes for the coming year. In recent years, focus groups of customers have also been invited to provide ideas and opinions in the process. The selected products are then added to the upcoming catalogue and will be sold throughout the year. Historical sales analysis and future forecast also plays an important role in selecting the products.

SMC negotiates with vendors through service level agreements (SLA's) to get favorable terms and conditions on products' supply and pricing. The average gross margin for a T-shirt is around 15%, but the exclusive distribution right with PING® contributes over 25% gross margin to SMC. The recently added category of the work wear program is also successful because no other wholesaler carries this product line, which allows SMC to charge a monopoly price.

Partnering with low cost producers to continue to source lower cost products is always SMC's strategy. The recent development of suppliers in China and India helps SMC bring lower price products to the market and enjoy a higher margin.

3.1.2 R&D Expenses

As a wholesale distributor, SMC does not invest on new product development. But SMC invests on improving computer systems and developing employees' skills to increase its competitive advantage. Over time, employees become SMC's most valuable asset. The customer database with 15,000 customers, sales history and analysis allows SMC to target a particular market by offering best-selected products. Therefore, the R&D expenses are minimal.

SMC invests a lot to customize and upgrade the computer systems and process to make it easier for customers to shop at SMC. Also, SMC works with suppliers to develop low cost manufacturing in Asia.

3.1.3 Organization Structure

SMC has a centralized structure where the main functional departments are based in the Richmond head office. The other three distribution centers execute order processing and warehousing activities. Headquarters centralizes major strategic initiatives such as product selection, sales and promotion planning, process improvements, human resource and IT support.

Key changes are initiated from head office. Head office also manages the budgets and expenses.

3.1.4 Decision Making

Key decisions are made by the four senior managers in the head office and are carried out through the branches. The key decisions include sale forecast and budgeting, product selection and promotion plans, business development plans, process changes and improvements, staffing, supplier agreements as well as service level agreements.

Aligning with the strategic directions, department managers are responsible respectively for their own departmental actions plans, operations and collaboration with cross-functional departments. Any decisions involving cross-functional departments have to be finalized by senior managers. As such, the middle management has little autonomy to make decisions but must execute what has been decided. The decision making process is basically top-down.

3.1.5 Manufacturing & distribution

SMC does not manufacture but distributes products.

SMC sells millions of T-shirts that helps to achieve economies of scale. SMC gets the best deal from suppliers because of a high volume of inventory turnover. Even though SMC constantly carries 10% discontinued products, most of its products are not fashionable and can be sold year after year.

SMC continues to shrink the number of SKUs in order to achieve greater economies of scale for the best selling products, and introduces new products to increase its market share.

SMC has an efficient distribution network. UPS and Purolator distribute 90% of the products to 15,000 customers within 1-3 days on average. Fast service and an efficient distribution network help SMC retain customers. The large shipping volume allows SMC to negotiate shipping rates with the carriers.

3.1.6 Labor

Sixty percent of SMC's labor forces are low skilled workers who pick, check and ship orders. The next 20% of labor are trained as customer service representatives who take orders over the phone and answer customers' inquiries. The remaining 20% are

management staff and office clerks who are responsible for planning, execution and administration.

The company tries its best to retain its employees. Actually, there were 41 employees who had more than 5 years of individual service at SMC, and 33 of them are still working for the company. All 11 employees who had more than 10 years of individual service at SMC are still working for the company, and 6 of them are managers. The low people turnover keeps the company's labor costs low and skills retained.

In recent years, SMC has invested a lot on training employees with potential competencies by offering promotions. SMC encourages employees to take job-required training by providing loans and other forms of financial support.

3.1.7 Marketing

SMC pushes products to the market by giving incentives to customers.

The marketing department plays various roles in the company that includes product selection, product catalogue design and print, pricing and promotion, trade show, market research, survey and website update.

SMC does not actively advertise its brands or products through media. The key promotion methods include mailing out catalogues, delivering promotion information through emails and faxes, and displaying sales flyers in the company. Price discounts and incentives to customers are also widely used.

Customers are well informed by emails, faxes and phone calls before promotion periods when they usually take advantages of promotions to order. However, pricing advantages on some products also entice customers to buy other products. Hence,

customers always come back for future orders not only because of the pricing alone but also for the wide range of selection and service.

The marketing department pushes products, and provides sales information to its customers in order to achieve greater sales revenue. Price reduction in the promotion period is used and proven to be effective.

3.1.8 Risk Profile

SMC runs its business at very low risk. Fifteen thousand customers provide SMC a stable business. A wide range of product selection and limited fashionable items allow SMC to sell its products all year long. Ninety percent of SMC's assets are its 15-20 million dollars of inventory that is easy to liquidate. The remaining 10% are computer and warehouse equipment. Without heavy investments in fixed assets, SMC can easily make a move to another business if the business environment or economy changes.

SMC rents warehouse and office space where it is flexible to adjust space and thereby negotiate for a better rate. SMC tries to run its business as lean as possible. "Back to the basic" has always been its focus.

3.1.9 Capital Structure

SMC has 20% equity that is from four major shareholders and 80% debt that is from banks. The current assets are more than enough to cover the debt. SMC has no problem getting more loans from the bank if needed.

SMC has enjoyed the profits over many years. It is estimated that the capital structure will remain the same in the future.

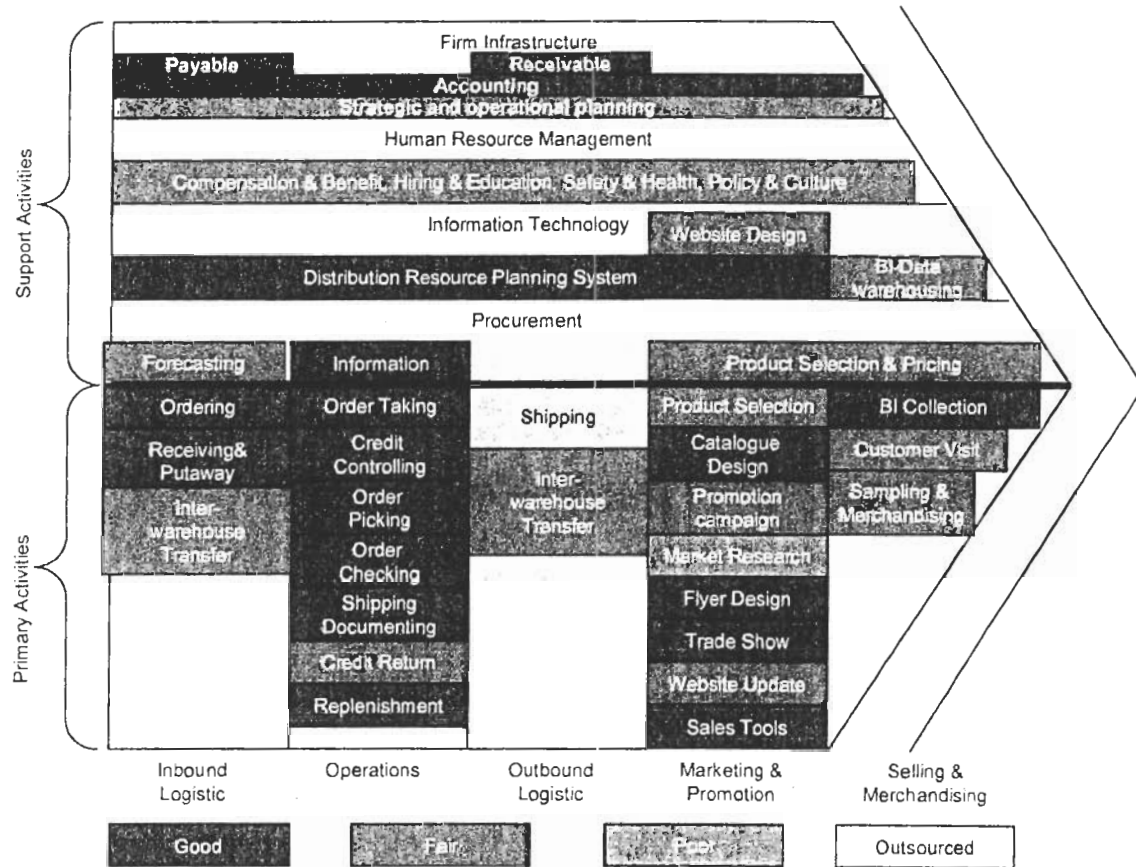
3.1.10 Conclusion

SMC generally fits Porter's cost-based strategy. SMC offers basic and homogeneous products in a large volume to achieve the economies of scale that helps it keep the costs low. The centralized organizational structure ensures decisions are made in head office and executed in all branches quickly and consistently. Selling products in large volume offsets the relatively low gross margin. Even though salary is one of the major expenses of the company, labor costs remain low because low skilled casual laborers are hired for operations. And low people turnover reduces hiring and training costs. Marketing pushes products to the markets by offering sales promotions and other incentives. Marketing spends little on advertisings, which keeps the marketing expenses relatively low. SMC's business risk is low because buyers have low bargaining power and the massive customer base provides SMC a stable business. SMC has 90% of current assets that are easy to liquidate if the market changes. SMC has a leveraged capital structure, which is 80% composed of loans from financial institutions.

3.2 The Value Chain of SMC

The following value chain analysis identifies the activities that SMC carries out in producing its services. It examines how these activities are organized and the interconnections between these activities.

Figure 6 Value Chain of SMC



Based on: Porter 1985

3.2.1 The Primary Activities

By adopting the “Source-Store-Sell” model, SMC starts its primary activities by purchasing apparel from manufacturers. Then SMC stores the apparel in four warehouses in order to fill customer orders. The order fulfillment process starts when customers call in, fax in, email in or order online and completes by shipping via contracted carriers, by UPS or Purolator. The marketing and promotion activities could happen before or after

operations. For regular items, customers order them with or without promotion. For on-sale items, the promotion activities begin earlier than operations. Selling and merchandising are purely servicing activities. Salespersons and merchandisers usually do not take orders but focus on building customer relations by introducing new products and helping to merchandise the products.

3.2.2 Core Competencies

SMC's core competencies are its abilities to fill customer orders quickly with a full range of products to select from and to consistently meet customer expectations. Providing "one-stop-shop" to customers and "Easy-shop-at-SMC" are SMC's strategies to compete. Also, SMC develops effective marketing and promotion campaigns to push products into the market. Moreover, SMC continues to train and successfully retain competent staff who are the most valuable assets to the company.

3.2.3 Inbound Logistic

Inbound logistic begins with procurement's planning of sourcing products for the company to sell. Procurement uses fairly straightforward but complex methods for planning.

First, procurement selects products and maintains inventory to meet changing customer needs.

Product selection is a complex process. SMC has a guideline to introduce 10% new products every year and discontinue 10% old products by SKU. The process begins with an in-depth product sales analysis by brands, by styles, by colors and by sizes for the prior year. The idea is to identify which products performed well and those that did not. The products that performed poorly will be eliminated from the upcoming catalogue. The

current inventory of discontinued products will be sold at or below cost. The products that performed well will be maintained in the catalogue. The following elements will be considered in the new product selection process.

- Similar products under the same brand
- Similar style with additional features
- Companion products in addition to the current products
- Products that competitors carry but SMC does not
- Fashion trend information from trade shows
- New materials and products developed by suppliers
- Gross margin performance

Procurement also invites sales, marketing and customer focus groups to see the new products before finalizing the plan. Once the new products are selected, a forecast of purchasing plans will be drafted with support of a financial and profitability analysis.

Procurement also manages inventory, more than 65% of SMC's total assets. Managing 200 styles and 6000 SKUs is a complex job. Procurement uses the following Table 6 to monitor and adjust inventory level.

Table 6 Worksheet to monitor inventory turns

Product A: Inventory Turns/ MOH Diagnostics										
Style	Description	2005								
A	SWEATSHIRT	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep
1	Average Inventory (DZ)	360	394	603	757	845				
2	Ending Inventory (DZ)	345	442	764	749	940				
3	Sales Forecast	87	85	138	244	552	432	405	205	48
4	Adjusted forecast	87	96	157	277	628	490	295	150	35
5	% change	0%	14%	14%	14%	14%	14%	-27%	-27%	-27%
6	dollars change	0	396	645	1,142	2,583	2,018	-3,747	-1,903	-442
7	Actual	20	50	104	201	307				
8	Variance %	-77%	-41%	-25%	-18%	-44%	-100%	-100%	-100%	-100%
9	Variance vs. adjusted	-77%	-48%	-34%	-28%	-51%	-100%	-100%	-100%	-100%
10	Inventory Needed	172	223	382	796	984	836	610	253	126
11	Inventory Cost	5896	7633	13103	27318	33746	28678	20921	8684	4333
12	MOH Target	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00
13	MOH Actual	2.22	1.33	2.44	2.71	5.36	0.00	0.00	0.00	0.00
14	Inventory Turn Target	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00
15	Actual Inventory Turn	0.67	1.17	1.32	1.78	2.55	2.77	3.06	3.33	3.81

Data source: SMC's internal purchasing reports

The fundamental principle is to set MOH target, month on hand. MOH means inventory should be kept in such a level that it meets the following months sales forecast. As illustrated in Table 6, the MOH is targeted to be 2 for every month. That means the inventory level will be planned to cover the current and the following month sales based on adjusted forecast. The actual MOH is usually greater than planned so that a buffer is reserved to meet any unexpected demand from the market. Inventory turn works together with MOH. In this case, the inventory turn is targeted to be 6, which means the inventory stays in the warehouse for 2 months or turns 6 times a year. The actual inventory is correlated to the sales forecast with the predefined MOH parameter. If the actual sales do not perform according to the plan, procurement will modify the existing purchase orders and inform vendors to delay or speed up the shipment. As such, the inventory level will be decreased or increased. The inventory is monitored by each individual buyer on a daily basis and reviewed by the procurement group twice a week. In order to properly manage the inventory, 200 worksheets are created and updated by the procurement team.

Second, procurement monitors forecasts and order adjustments. With the help of integrated distribution resource planning system, procurement is able to modify the forecast figure in the system. Because the sales and inventory information are also updated in the system, the recommendations to modify the purchase orders are generated automatically by the system with the inclusion of pre-defined business rules.

Third, procurement turns inventory to maintain and increase company profitability. Procurement is required to constantly turn inventory faster. Faster inventory turn means lower inventory cost for the company. Cash will be freed up so less working capital is required, thus, less bank loan is required, which in turn reduces interest costs.

Profitability will be increased over time. It requires procurement to evaluate and negotiate with suppliers for shorter purchase lead-time and smaller purchase quantity that allows greater flexibility for procurement to modify purchase orders. It also requires procurement to work closely with sales and marketing departments to increase sales so that inventory is moving out faster. The faster inventory turn will also possibly reduce warehouse space so that less rent will be paid. Therefore, profitability will be increased.

Last, procurement develops reporting mechanisms and systems to analyze the movement of products and shares the information with suppliers and co-workers.

Then procurement places purchase orders to manufacturers. SMC sources most of its products offshore for one reason, low cost. In order to balance cost, purchase lead-time and inventory level, SMC signs SLA's with manufacturers for clearly defined terms and conditions. Moreover, to achieve win-win for both parties, SMC provides its forecast and purchasing plan to manufacturers electronically. This information helps manufacturers smooth their supply chain management, especially their planning process. SMC commits the required purchase orders to the manufacturers and only allow the manufacturers to release the purchase orders when SMC has very firm demands, which are either from customer orders or a need to replenish inventory. As such, SMC achieves reasonably high inventory turns and low inventory costs by managing supplier relationship well.

Overtime, SMC has improved its processes and technologies on receiving goods. Continued from purchase orders placed, warehouse receives an ASN, advanced shipping notification, from manufacturers when goods are shipped out. The ASN is an electronic format of shipping document that can be uploaded to SMC's system. The ASN consists

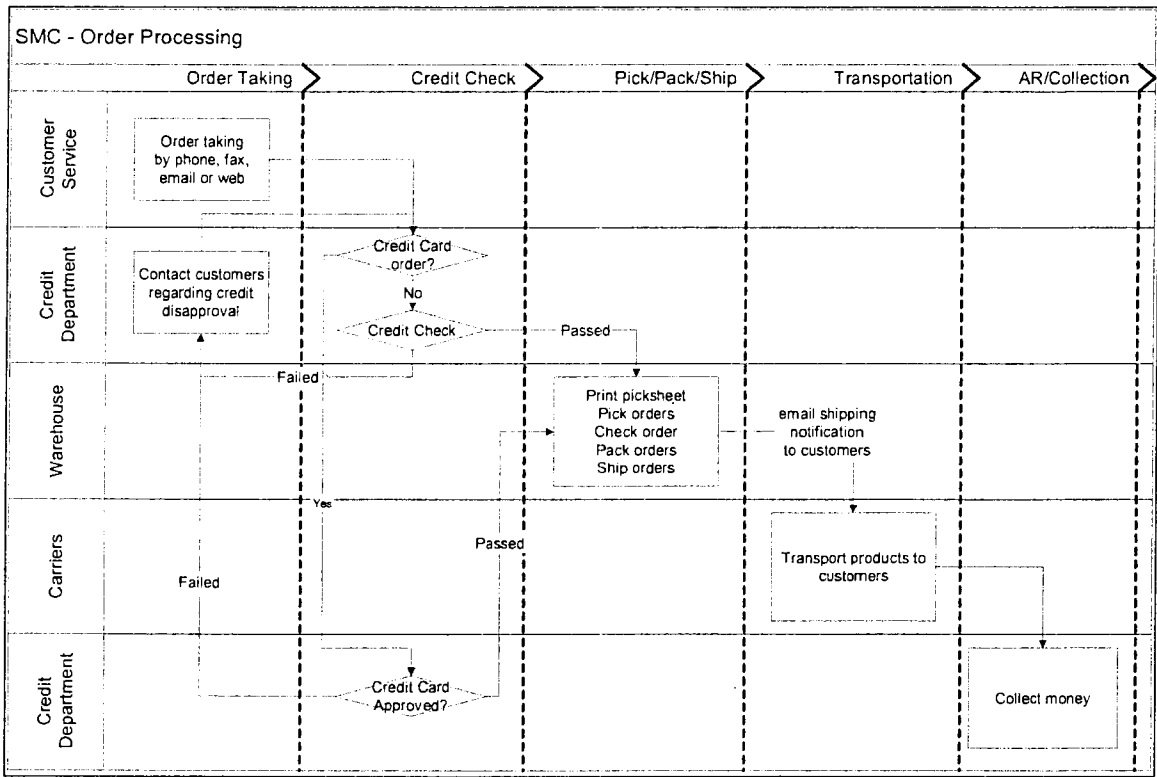
of detailed information of shipments that can be matched with the original purchase orders. As such, warehouse operators know what to receive in the next shipment. The ETA, estimated time of arrival, is reasonably accurate so that warehouse operators can reserve spaces for incoming goods. With the help of ASN, warehouse space required can be calculated and reserved in advance. SMC also requires all manufactures to be compliant with GTIN, global trade identification number, or barcode standard. The RF, radio frequency, and barcode scanning technologies are used to speed up the receiving process. Sophisticated intelligence and logic are built into the receiving program to direct where to put-away products to the nearest available or empty locations. Inventory records are updated immediately when the products are put-away. Consequently, the products are available for sale. The receiving process is streamlined and efficient. Three people can unload a full 40 ft. trailer and put-away within three hours. A discrepancy report will be generated automatically so that operators can analyze the report and deal with the discrepancies.

Operators receive products not only from suppliers but also from other warehouses. Occasionally, customer orders are split and shipped from multiple warehouses because there is not enough stock in a particular warehouse. This increases shipping and handling charges to customers and also effects customer service. In order to minimize the split shipments, sometimes products are transferred inter-warehouse based on pre-defined criteria.

3.2.4 Operations

The operations start when customer service takes orders and ends when the credit department collects the money. The operations are the most critical activity for SMC to be successful in serving its customers. Figure 7 illustrates the order processing.

Figure 7 SMC's order processing flow



Data source: SMC's internal process mapping

SMC has two call-centers located in Richmond and Mississauga to provide 12 hours call-in order service. SMC receives orders through phone, fax, email and web. The majority of the orders are taken by phone. By using the integrated distribution resource planning system, inventory availability is checked when placing an order. Customers are informed whether the order will be shipped completed, or split and shipped from multiple warehouses, or back-ordered. An order acknowledgement email will be sent automatically to the customer when the order is placed. The email has information such

as products ordered and their quantity and price, as well as the shipping and handling charges. The order information stays in the system and is passed to the credit department for credit check.

The credit department controls the orders, deciding whether to release them to warehouses or to hold until customers' funds are available. The credit department does this according to customer's credit terms and other criteria.

For the credit card orders, SMC's distribution resource planning system is integrated with the credit card company's processing system; the customer's credit card is automatically checked by the system and then will be pre-authorized by the total order amount if passed. If the credit card pre-authorization fails, then the order will be put on-hold. The credit department will be notified to contact the customers. The pre-authorized orders will be released to warehouses. SMC encourages customers to use credit card to order because it improves efficiency on credit check and fund collection. Even though it pays a service charge to the credit card Company for every credit card transaction, SMC does not charge customers an extra fee for credit card payment. The service charge is offset by the efficiency gained and lower bad debt. Around 30% of SMC's sales are done through credit card payment.

As for the net terms customers, sophisticated business rules are set up in the system that customer's credit limit, credit terms, outstanding accounts receivable, payment history, and sales history are checked. If the order meets the auto-release criteria, the order will be released to warehouses. If it fails, then the credit department will contact the customer and proper actions will be taken.

For the other types of orders, they are automatically put on-hold. The credit department will not release the orders until the funds are secured.

The credit department plays a role to proactively control order release, which helps to streamline the rest of the processes of the operations.

Table 7 Average time of credit release for 2004

Averages time of order release for 2004					
	0-15 MIN	15-30 MIN.	30-45 MIN.	45-60 MIN.	60+MIN.
WEST	92%	3%	1%	0%	4%
EAST	88%	4%	1%	0%	7%

Data source: SMC's internal reports

Table 7 indicates that 95% of the orders are released within 30 minutes. This supports SMC's customer service promise of shipping the orders placed before 3:00pm on the same day.

The credit department also reviews customers' credit rating regularly. The customers who failed the credit review will be added into the "black-list". Any new orders placed by those customers on the list will be automatically held by credit. All these orders need to be reviewed by the credit department before releasing to warehouse for further processing. As such, the bad debt is lower than 1% of total sales revenue and the collections are on time to generate stable cash inflow.

All the released orders enter into the warehouse's pick-list print queue. In order to provide expected customer service and ensure the orders are ready to be picked up or shipped, warehouse prioritizes pick-lists to be printed. The priority is always given to pickup orders. The orders have to be ready before customers come to pick up. This is an important measurement for customer services. In order to achieve this, the exact time that

the customer expects to pick up is kept and highlighted when an order is taken. The pick-lists for pickup orders are printed according to pickup time by ascending order. For the rest of the orders, it is based on first come first serve principle unless a special note is marked on the order for urgent process.

The pick-list operator who has override control on the printing can overrule this pick-list print priority. This allows sufficient flexibility to properly prioritize the order picking sequence.

The picking team will pick orders according to the best-defined route in the warehouse. Products are put into boxes and then are put on the outbound conveyers for checking. The boxes are weighed by electronic scale and uploaded to the system to get actual shipping charges. All the boxes have to be checked before they are released for billing.

Boxes are moved to the billing station once checkers have checked them. The billing system is integrated with the carrier's shipping system. That shipping information is transferred to the carrier's system as soon as the orders are invoiced. At this moment, credit cards will be charged with the actual total invoice amount for credit card orders or customer ledgers will be updated for other types of customers. Shipping labels are printed automatically from the carriers' shipping system with the information transferred from the billing system. Finally, customer invoices are printed and shipping confirmation emails will be sent to customers at the end of day.

The designated carriers arrive later in the day to pick up all the orders to be delivered.

The last step of the order processing is for the credit department to collect account receivables from customers.

The operations are highly automated and integrated so that SMC guarantees its customers quick delivery. Depending on the customers' location, the shipment will be delivered within 1 to 3 days across the country. Such commitment to the customers' need differentiates SMC from the competitors and makes SMC stand out from the competition. Due to the consistency in performance, SMC is able to retain its customers and constantly expand its customer base.

3.2.5 Outbound Logistic

UPS, Purolator and other carriers ship 90% of SMC's orders. SMC out-sources its outbound logistic. Due to the volume of shipments, SMC is able to negotiate better rates with UPS and Purolator, as well as integrate its order processing system with carriers to achieve greater efficiency. Typically, UPS and Purolator come in late afternoon and load all the shipments in a batch. There are very few orders sitting in the shipping area overnight mainly for credit check reasons. SMC's distribution resource planning system is integrated with UPS' and Purolator's shipping system. As soon as an order is invoiced, the shipping and billing information is transferred to UPS' or Purolator's system which then prints shipping labels. This integration improves efficiency in shipping and reduces redundancies in data entry. Customers receive shipping confirmation emails with tracking numbers when orders are invoiced.

SMC also packs orders for local pick-ups. The pickup orders are sorted alphabetically by the company's name in the pickup area. The pickup area has the latest sales and promotion information that keeps customers informed.

3.2.6 Marketing and Promotion

The marketing department's mandate is to promote SMC and its products in the most appropriate and effective manner in order to maintain and increase sales and its customer base. It also acts as a support to sales and customer service departments by providing sales tools to effectively sell the products.

The marketing department plays a vital role in selecting products. Product selection is critical to make SMC a "one-stop-shop" to its customers. Decisions need to be made on what products to be discontinued, what products to be continued and what new products to be introduced. Joining forces with sales and purchasing teams, the marketing department collects and compiles huge amount of information on fashion, industrial trend, product sales analysis, geographic analysis, demographic analysis, economic factors, and competition etc. While reducing the number of SKUs, SMC needs to carry full range of products so as to serve its customers and provide a "one-stop-shop" experience. This is a complex task and SMC does a fair job. To support this judgment, about 10% of total inventories are closeout items that have to be sold at or below cost. This lowers SMC's gross margin performance.

SMC produces the most shoppable catalogue in the industry. Joint with Sales and purchasing departments, marketing department finalizes the product lines that will be carried in the next year. A local advertising agent coordinates photo shooting by hiring models and photographers. The new catalogue production starts in April and ends in November. SMC offers three versions of catalogues, which are as follows.

Figure 8 SMC's product catalogues



Source: SMC's product catalogues, by permission

SMC's catalogue provides full pictures of products with SMC's contact information as shown in Figure 8.

The generic (Corporate) catalogue shows products in SMC's catalogue but without SMC's logo or contact information. So that SMC's customers can print their own logo and contact information on the generic catalogue to promote SMC's full product line as their own product line. This saves customers' a significant amount of time and money in producing their own catalogue. The suggested retail price is included in the generic catalogue, which helps customers price the products.

The generic (Sportswear) catalogue provides only sportswear that SMC carries. This version is designed for those customers mainly dealing with sportswear.

The marketing department is also responsible for maintaining the following sales tools.

Online Catalogue Image Library on website

Making all the high-resolution images available on website allows customers to download the images they like. These images are licensed to customers so they can reuse

the images to print on any promotion free of charge. The marketing department ensures the images are up-to-date.

Generic Online Catalogue

Customers also can download the whole generic catalogue from the website to reproduce their own catalogue with minimum modification required. This is a digital version of the generic catalogue that can be printed with press quality in Kinko's or other publishing house.

Specially Priced Samples

SMC offers samples of new products to customers at a very low price with certain conditions, such as quantity and time to purchase.

Price Lists

The marketing department constantly updates the price lists to reflect on-sale activities and market changes.

Sales and promotions

The marketing department runs sales and promotions almost every week. The most effective method is through sales flyers, which are emailed or faxed to customers.

Generic eFlyers

An eFlyer is created for every sales and promotion. The marketing department also creates a generic version that the customers can easily download for promotions to their customers at the same period of time when SMC runs a sale.

The marketing department blasts faxes or emails flyers to all customers who are email or fax contactable. This is an effective and efficient way to stay in touch with existing customers by informing them of the latest sales information.

Closeout list

The marketing department also keeps the closeout list up-to-date.

The marketing department coordinates to attend two major industry trade-shows every year. Partnered with manufacturers, trade-shows provide a very good opportunity to showcase SMC's commitments to the market, as well as to signal competitors that SMC continues to be strong in the market. SMC is able to acquire hundreds of new customers after a trade-show.

There is one weak area existing in the marketing department. That is lack of market research. That reduces SMC's ability to understand what customers want. Indirectly, this might contribute to massive closeouts and high inventory levels.

3.2.7 Selling and Merchandising

The sales department establishes sales policies, plans, and strategies that will meet and exceed company's sales target and be consistent with the company's mission statement.

The sales team does a fair job at collecting industry information, or business intelligence by formal or informal channels. This business intelligence helps SMC adjust its selling strategies in time to focus market, promote products and gain market share. This intelligence is well communicated among decision makers within the company. An action plan is then quickly initiated and adjusted according to market changes.

It is difficult for only two full time salespersons to visit thousands of customers. Customers complain about not meeting SMC's sales representative for years, which makes it easier for customers to switch to competitors. SMC realized this issue and rolled out the merchandiser program to ultimately have merchandisers cover almost every

province to increase its sales force presence. The merchandisers take responsibilities to visit customers, help them display SMC's products in their showroom, offer samples and collect feedback from customers. By doing so, SMC hopes to strengthen customer relationships, and retain customers.

Merchandisers have a target of how many customers to visit on a weekly basis. Also, they have targets to create new customers as part of their performance measurements and compensations.

The merchandiser program has proven to be very successful in Alberta and Ontario where SMC used to have a weak sales presence. The program will be rolled out to every province.

3.2.8 The Supporting Activities

SMC's supporting activities are strategically aligned with its primary activities in order to achieve greater efficiency and become the best active-wear distributor in Canada.

3.2.9 Procurement

Procurement plays various roles in the supporting activities. The mandate for procurement is to select active-wear products that will most appeal to customer needs and thereby produce sales. Also, procurement purchases office supplies and warehouse supplies.

3.2.10 Information Technology

The information technology department is to provide and maintain the technological resources required to meet the company's goal.

Information Technology, hereafter referred to as "IT", is an enabler for SMC to gain its competitive advantages. By implementing and continuously enhancing

distribution resources planning system, IT provides a vehicle to integrate SMC's primary activities, especially for inbound logistic, operations and outbound logistic. Furthermore, by developing web technologies; IT helps the marketing department develop sales tools that strategically makes it easier for customers to shop at SMC. The data-warehouse system provides sales and marketing departments with insightful information to analyze historical sales at any detailed level. With the business intelligence on hand, salespersons and merchandisers have better focus on visiting customers and promoting products.

By introducing real time inventory and order online, SMC hopes to achieve more than 10% of its total orders from the web, which will put SMC well ahead of the competition. No other distributors in Canada have the technology advantage that provides 24/7 ordering system to customers.

The IT team consists of 3 full time employees and 3 external consultants who are dedicated to maintaining the distribution resource planning system. The annual budget for IT is about 5% of total G&A expenses in 2004.

3.2.11 Human Resources Management

The human resources department's mandate is to establish and monitor human resources policies on hiring, training, performance review, compensation and benefits, employee survey and other administrations.

SMC is able to hire, train and retain competent employees to support its business plan. It recognizes that employees are the most important assets to the company. Since the company was founded, SMC has been providing a fair but challenging working environment to support employee development and encourage long-term service. As a result, SMC has very low turnover in every key position.

SMC's employee philosophy

This philosophy guides relationships between company and employees, and between employees and other employees.

- Employees who are happy contribute to the company and employees who contribute are happy
- If the company provides a fair and challenging work environment, the employees will rise to and meet those challenges
- Employees are the most important assets at SMC – they make this operation possible.
- A healthy work environment contributes to the personal development of an individual
- Employees who are growing and improving personally and professionally are more productive than those that are not
- All employees have an equal opportunity to excel within the company
- The opinion of every employee is valuable in making SMC a better company

One of SMC's core competencies is to hire, train and retain competent staff. The hiring process can take 2 weeks (for an internal hire) to 8 weeks (for an external hire), plus time required by the employee for giving notice, which may be another 2-4 additional weeks. The followings are a checklist for hiring.

- Review job description, ensure it is up to date; obtain feedback from others in department if required
- Determine salary range for position
- Create an internal posting and place in established locations for minimum of 5 days
- Consider whether job will be posted externally
- Decide who will be involved in the interview and selection process
- Prepare interview questions
- Screen all resumes against the qualifying criteria set out in the job description
- Create shortlist for first interviews and set appointments
- Conduct first interviews
- Shortlist candidates for second interviews
- Conduct second interviews
- Check references of candidates being considered for hiring
- Make selection decision
- Offer job to the best candidate

- Send an offer letter to the selected candidate
- Inform payroll for new employee and create a file for the new employee
- Send regret letters to other candidates
- Send employee handbook to new employee
- Send memo within the company announcing the new employee
- Plan orientation for new employee

The hiring process is conducted in a careful but fair manner in order to hire the best candidate. The hiring process is clearly documented in the manager's handbook.

SMC will help employees explore career related learning opportunities through courses, seminars and on-the-job training.

SMC has implemented a performance review program. A new employee must complete a three months, six months for managers, probation period before becoming a permanent employee. The performance review program is to let the employee know exactly what is expected of the employee, assess the employee's performance and provide feedback on how the employee can improve. The permanent employee will receive an annual review that will consist of

- 1) Peer reviews, where co-workers will be asked to review employee's strengths and areas for improvements,
- 2) A self-appraisal where an employee comments on his / her achievements, goals and areas for improvement and
- 3) A review by immediate supervisor.

Together, these will form the basis of setting the employee's future goals and salary package. For the company, a review progress report will be reviewed at a weekly management meeting to keep all the reviews up-to-date.

SMC participates in the industry survey that examines salary, compensation and benefits every two years. This keeps SMC competitive in the market to attract and retain competent people. Based on the survey result, salary will be reviewed and adjusted to market value accordingly.

Also, the employee survey is adopted to get employees' comments on how the company performs on cultural, and employee development areas. An action plan to improve the weak areas identified from the survey will be implemented.

By doing all this, SMC has achieved very low people turnover. Long-term employees are retained. Lots of them are managers and employees in critical positions.

3.2.12 Accounting

The accounting department is required to generate and provide timely and accurate financial information to all stakeholders.

Keeping the financial books current is accounting's fundamental job. By generating and analyzing financial reports, accounting provides updates on company's financial performance. Managers rely on this information to control cost and spend wisely.

Accounting joins procurement to negotiate longer accounts payable terms and credit to negotiate shorter accounts receivable terms that improves company's cash flow.

Accounting also coordinates annual stock take and external audit.

3.2.13 Firm Infrastructure

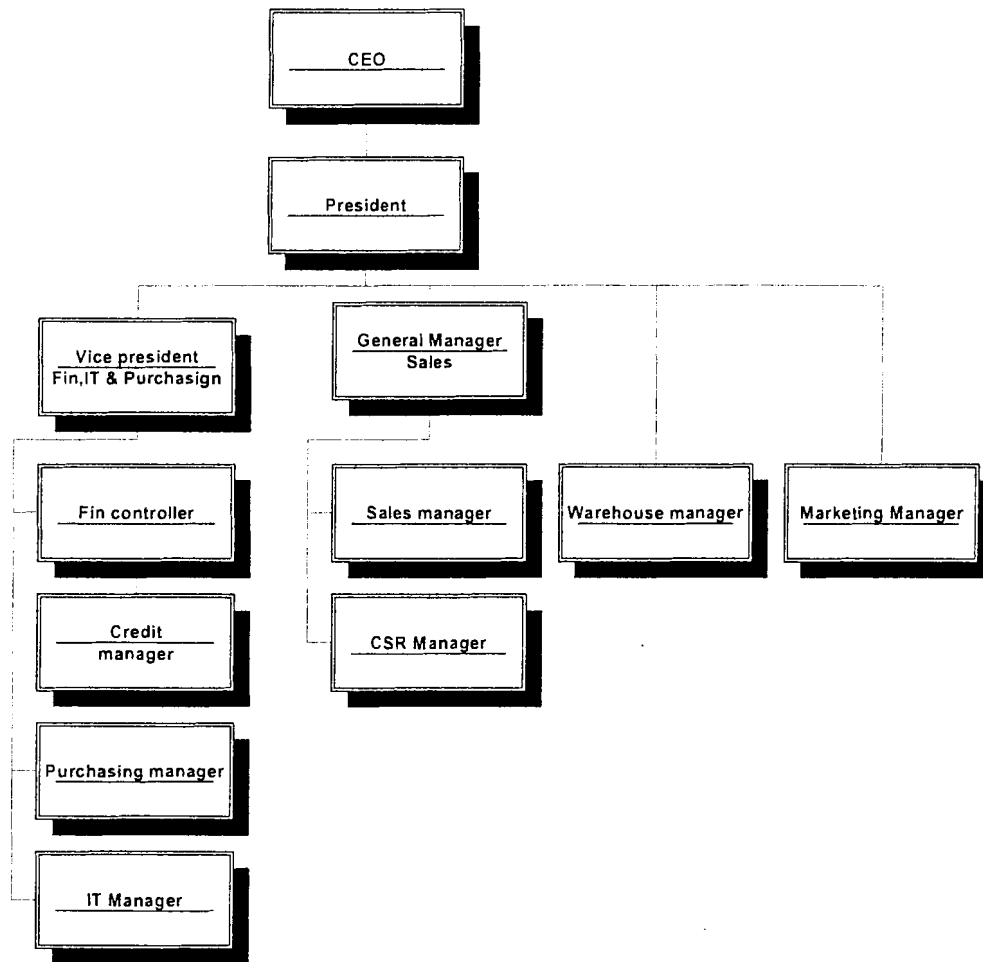
The firm infrastructure is structured to support primary activities. Eighty five percent of workforce works for the primary activities. Typically, the supporting departments are small in size but well run.

Table 8 SMC's headcount

Sales	CSR	Ware-house	Purchasing	Marketing	Finance	Credit	IT	HR	Senior Managers
7	14	55	5	4	3	5	3	1	4

Data source: SMC's manager handbook

Figure 9 SMC's organization chart



Data source: SMC's employee's handbook.

3.2.14 Summary

SMC maintains its unique position acting as a bridge between manufacturers and customers. As such, manufacturers do not need to deal with thousands of customers but focus on their core competencies on introducing new products and manufacturing quality but low cost products. By carrying a full range of products and large inventories, SMC provides customers with a “one-stop-shop” experience that adds tremendous value to the customer. Customers not only purchase the products but also unique shopping

experiences and receive excellent service from SMC that not every other distributor is able to offer.

By highly integrating its supporting activities with primary activities, SMC is able to ship orders more quickly than its competitors so customers' expectations are met constantly. By getting closer to customers and understanding their needs, SMC takes more proactive approaches to serve its customers.

By introducing more technologies, SMC is committed to make it easy to shop at SMC.

3.3 SMC's planning process

SMC's senior management is capable of strategically arranging its primary and secondary activities towards one common goal – providing superior services to customers. Senior management possesses extensive experiences in sales, operations, finance and strategic planning. With help of an external consultant on strategic planning and execution, SMC's current strategies were established in 1996 and are still applicable to the existing environment. The strategic plan provides guidelines for the company's short-term and long-term directions, as well as being updated as required.

SMC has adopted a Top-down annual planning process to guide and integrate departmental action plans in order to achieve the company's common goals.

In 2001, the senior management team identified four key strategic areas and four long-term objectives. These areas and objects are to be focused on in order to fulfill the company's mission and maintain a viable long-term business. Table 9 illustrates the key strategic areas and long-term objectives.

Table 9 Key Strategic Areas and long-term objective set up in 2001

Key Strategic Areas	Long-term objectives
Future markets/products	To establish a product mix that improves gross margin performance
Human competencies	To have the managerial technical and human relations competencies to support the company's growth through to 2003
Inventory management	To maintain our closeout inventory to a reasonable level of our average inventory value by January 2003
Improving business practices	To improve the ability of CSR's to take more orders by sales dollar value per person and warehouse to ship more orders by dollar value per person by 2003

Data source: SMC internal action plan

The annual planning process begins in August and finalizes in October. Usually, senior management identifies the key areas of focus. Specific objectives will be set for those areas. The objectives are set by S.M.A.R.T principles. Then managers are asked to draft departmental initiatives to support the company's goals. The following is an example for the annual management meeting in 2004 to plan for 2005 action plan.

Four major categories were reviewed:

- The financial framework
- The sales targets and projects growth areas
- The inventory and product mix
- The productivity progress

Below were examples of key departmental initiatives to support the four categories.

Sales: continuing development of sales merchandisers program – a new way of servicing customers in the field.

Marketing: Add the ability for customers to order on-line. This includes ability for customers to determine if we have sufficient stock 24 hours a day.

Purchasing: Establishing measurement to determine how well the vendors and buyers meet pre-determined targets.

Customer service: Developing benchmarks based on criteria of measurements to measure productivity and ensuring SMC remains No.1 in the eyes of customers

Operations: continuing improvement through a combination of RF automation and process improvement in the way of handling products.

Accounting: Introducing a flexible budgeting system.

IT: Continual development of web site.

The manager reviews the annual departmental action plans jointly with the senior manager to ensure the plans are aligned with the company's goal. Measurements will be set up to monitor and review during the year. As such, synergy from all departments will be achieved in order to make SMC more competitive in the market place.

3.4. SMC's competitive advantage

First, SMC has the best selection of products with enough inventories to meet the customers' needs.

Second, SMC processes customer orders quickly and consistently to meet its service promise to customers. The consistent customer service of shipping the orders on the same day if placed before 3:00pm and delivering within 1-3 days to anywhere in the country makes SMC stay ahead of the competition. Customers are confident that SMC can deliver the orders on time. Also, SMC continues to develop new technologies that make it easier to shop at SMC. This provides additional value to customers.

Third, SMC provides sales tools to help customers sell their products more effectively. SMC's marketing department develops many sales tools, such as on-line products images, digital product catalogues, and eFlyers that greatly help customers sell SMC's products.

Last, SMC is the cost leader in the industry who provides a full package of services to customers. SMC offers the same products at lower prices or same prices with more value to customers. What customers receive are not only great products, but also unique shopping experiences with SMC.

Competitors might be able to copy one or two strategies from the above list, but it is difficult for them to copy all of SMC's ideas. That keeps SMC competitive in the market.

3.5 SMC's culture

SMC promotes family culture. The ex-president, who was also the co-founder of the company, is a very family-oriented person who wanted to extend and promote family culture into the work place. Having fun is an important part of work at SMC. Friendly chats and conversations are encouraged between co-workers. Music is allowed in the warehouses. Flexible working hours are also allowed for employees in non-operation departments. SMC also provides a competitive benefits package. Offering gifts and the recognition of employee birthdays and anniversaries is a common practice at SMC. The annual golf tournament and Christmas party are great events to get together to have some family fun. Free BBQ lunches are offered in summer time. A day when kids can visit the facilities always results in attendance of many family members.

SMC focuses on customer services. SMC recognizes that excellent customer services are the key to survival and growth. The company is set up and the processes are organized to provide excellent customer services. Any ideas and recommendations that improve customer services are welcome and evaluated. Measurements are set up and monitored according to the company's overall service goals at the department level.

Customers' participation in product selection and focus groups for service improvement is highly recommended and used. Senior managers often talk to customers for all kinds of feedback.

SMC's management style is informal. SMC has a flat reporting structure that allows managers to work closely with front line employees. SMC has weekly manager meetings where action plans and key activities are reported and updated in a relaxed atmosphere. Every department organizes its own meeting at various times to keep it functioning. Departmental update and activities are shared with employees via internal newsletter or the company's bulletin board. The senior managers have monthly meetings with their direct managers to ensure the departments are functioning properly. Employees are free and encouraged to talk to any level of manager about their concerns and suggestions.

SMC is a sales and distribution company that looks for profitable growth. SMC encourages any initiatives to grow the company profitably. The company and departmental action plans are designed to support sales and distribution activities. Frequent discussion topics are the sales update and order fulfillment performance.

3.6 SMC's financial analysis

3.6.1 SMC's financial statements

Table 10 Balance sheet 2001-2004

SMC				
Balance Sheet (Summary)				
	2004	2003	2002	2001
ASSETS				
Current Assets				
Accounts receivable	\$ 5,252,925	\$ 4,397,797	\$ 5,463,789	\$ 5,786,971
Income Taxes Receivable	285,747			
Inventory	12,715,371	12,997,366	13,574,953	12,370,209
Repaid expenses and deposits	132,667	306,422	200,488	145,282
	<u>18,386,710</u>	<u>17,701,585</u>	<u>19,239,230</u>	<u>19,302,462</u>
Fixed assets	<u>877,151</u>	<u>912,700</u>	<u>976,627</u>	<u>1,058,549</u>
	<u>\$ 19,263,861</u>	<u>\$ 18,614,285</u>	<u>\$ 20,215,857</u>	<u>\$ 20,361,011</u>
LIABILITIES				
Current liabilities				
Bank indebtedness	\$ 6,801,711	\$ 5,696,541	\$ 7,771,002	\$ 6,346,154
Accounts payable & accrued liabilities	5,761,995	5,856,677	5,242,509	7,562,858
Income taxes payable	-	40,000	1,000	38,533
Debt	872,861	977,890	363,085	204,403
	<u>13,436,567</u>	<u>12,571,108</u>	<u>13,377,596</u>	<u>14,151,948</u>
Deferred tenant inducements	35,212	47,852	31,381	43,543
Long-term debt	-	400,000	992,254	505,078
Payable to related parties	1,266,325	1,266,325	1,665,325	1,641,325
Payable to shareholders	2,815,325	2,815,325	2,815,325	2,815,325
	<u>17,553,429</u>	<u>17,100,610</u>	<u>18,881,881</u>	<u>19,157,219</u>
SHAREHOLDERS' EQUITY				
Capital stock	100	100	100	100
Retained earnings	1,710,332	1,513,575	1,333,876	1,203,692
	<u>1,710,432</u>	<u>1,513,675</u>	<u>1,333,976</u>	<u>1,203,792</u>
	<u>\$ 19,263,861</u>	<u>\$ 18,614,285</u>	<u>\$ 20,215,857</u>	<u>\$ 20,361,011</u>

Data source: SMC's Audit reports

Table 11 Statement of Income 2004 - 2001

SMC				
Statement of Income (Summary)				
	2004	2003	2002	2001
Sales	\$ 42,780,686	\$ 51,769,525	\$ 59,441,459	\$ 56,014,654
Cost of Sales	34,619,705	43,511,408	50,692,976	47,259,507
Gross Profit	8,160,981	8,258,117	8,748,483	8,755,147
General and administrative expenses	7,886,624	7,966,782	8,539,151	8,513,950
Income before income taxes	274,357	291,335	209,332	144,710
Loss on disposal of fixed assets	-	-	-	(96,487)
Income taxes	77,600	111,636	79,148	49,000
Net income for the year	\$ 196,757	\$ 179,699	\$ 130,184	\$ 95,710

Data source: SMC's Audit reports

3.6.2 Financial ratios

Table 12 Ratio Analysis of SMC, 2001-2004

Ratio Analysis of SMC, 2001-2004				
	2004	2003	2002	2001
Profitability Ratios:				
Return on equity (%)	11.50%	11.87%	9.76%	7.95%
Return on asset (%)	1.02%	0.97%	0.64%	0.47%
Return on invested capital (%)	1.67%	1.61%	0.96%	0.83%
Profit Margin (%)	4.61%	0.35%	0.22%	0.17%
Gross Margin (%)	19.08%	15.95%	14.72%	15.63%
Turnover-Control Ratios:				
Asset turnover	2.22	2.78	2.94	2.75
Fixed-asset turnover	48.77	56.72	60.86	52.92
Inventory turnover	2.72	3.35	3.73	3.82
Collection period	44.82	31.01	33.55	44.22
Payables period	60.75	49.13	37.75	58.41
Leverage and liquidity Ratios:				
Asset to equity	11.26	12.30	15.15	16.91
Debt to assets	0.91	0.92	0.93	0.94
Debt to equity	10.26	11.30	14.15	15.91
Times interested earned	0.79	0.82	0.59	0.45
Times burden covered	0.02	0.04	0.02	0.01
Current ratio	1.37	1.41	1.44	1.36
Quick ratio	0.42	0.37	0.42	0.49

Data source: SMC's audit statement 2001-2004

Return on equity has a trend of steady growth. Over the past four years, ROE in 2004 is 45% higher than that in 2001. Return on asset has a healthy growing trend, so does the return on invested capital. The profit margin grows by 27 times from 2001 to 2004. This was achieved by two initiatives. One was to source and introduce higher gross margin products to the market. The introduction of PING, Brinell and Columbia helped SMC achieve higher gross margins. Another was to control expenditure and improve efficiency to keep the operating costs low. The gross margin remained flat from 2001 to

2003 but improved to 19% in 2004. Evidently, the fundamental earning power of SMC is increasing.

SMC's asset turnover has been constant from 2001 to 2003 and dropped slightly in 2004. SMC's assets change in correlation to the sales change. Especially for current assets, SMC's sales dropped from 2001 to 2004, its current assets shrank at the same time. It reflected that accounts receivable and inventory declined as sales dropped. During the post-911 economic downturn, the falling current assets provided the cash to repay loans. The fixed asset turnover falls constantly. SMC uses less fixed assets when sales drops. Or SMC does not invest on fixed assets at a great extend when sales drops. Also, the inventory turnover followed the similar trend to asset turnover. The reduced inventory turns were also due to the loss of breweries orders, which accounted for 2 million pieces T-shirt less in sales in 2004 than that in 2001. SMC achieved its highest sales record in 2002 and its inventory turnover in 2002 was the highest accordingly. This reflects the fact that SMC sold more products in 2002 than any other year. In 2004, SMC's sales was the lowest in the 4 comparison years, thus the inventory turnover was also the lowest. The collection period is shorter than payable period by 14 days, 4 days, 18 days and 16 days respectively in 2001, 2002, 2003 and 2004. SMC held a very good position in cash flow. Cash inflow was quicker than cash outflow by 15 days, except in 2002. This also resulted in less bank loan was required.

It appears that the improving profit margin is due primarily to a rising gross margin, indicating some combination of more aggressive pricing and better-cost control in products sourcing. The fact that SMC's sales have decreased over this period is consistent with selling higher gross margin products as the primary cause. The sales

decrease was partially due to the price decrease on major categories. In 2003, SMC sold 15 million T-shirts at average price of \$3. In 2004, SMC sold similar 15 million T-shirts at average price of \$2.50. The T-shirt alone accounted for \$7.5 million sales decrease. If the sales continue to drop, SMC might be in trouble that additional costs have to be cut. The slight fall of asset turnover is due primarily to a decline of inventory turnover. Fixed assets are less than 5% of total assets. The slight change on fixed assets turnover has minimum impact on asset turnover's change.

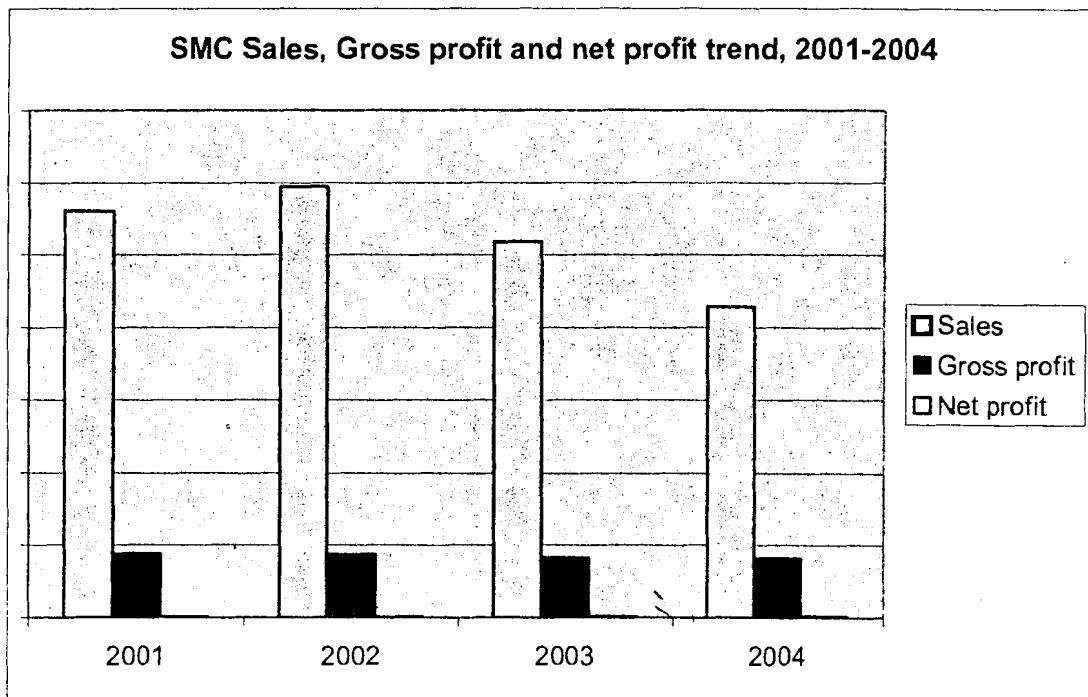
SMC's leverage and liquidity ratios show increasing confidence and commitment of shareholders. Shareholders re-invested the retained earnings back into the company. As a result, the shareholder's equity increases from \$1.2 million in 2001 to \$1.7 million in 2004 while the assets remain fairly constant. Therefore, asset to equity falls constantly. The debt to assets ratio remains unchanged because no new loan or debt has been applied. In other words, SMC re-invested the net income back into the company in this period. The debt to equity ratio falls because of the increased equity that shareholders re-invested back into the company. The time interested earned ratio which increased in this period shows that SMC relied less on loans from other financial institutions. From the income statement, the bank charges reduced over time. This might be due to the drop in interest rate and reduced financing requirement due to lower sales, which simply reduced purchases but offset by growing inventory levels. The increased times interested earned ratio is due to the increase in performance of the EBIT. The current ratio and quick ratio remain fairly constant indicating that SMC is able to manage its assets, especially the current assets, in correlation to the sales trend. And also the general and administration expenses are in line with the sales trend.

In summary, a ratio analysis of SMC reveals a profitable, declining business working very hard to change its financial and business landscape. SMC set its sales record in 2002. The company tried very hard to change the product mix in order to sell higher gross margin products while keeping other expenses low. Meanwhile, shareholders did not take any dividends and re-invested the money back into the company, which indicated their extreme confidence in the company's ability to turn around in the economic downturn. More positively, SMC aggressively seeks growth opportunities by introducing new initiatives, such as the merchandiser program and the possibility of entering into Quebec.

3.6.3 SMC sales, gross profit and net profit trend, 2001 – 2004

Figure 10 indicates SMC's sales, gross margin and profit trend from 2001 to 2004.

Figure 10 SMC Sales gross margin and profit trend, 2001-2004



Data source: SMC's internal reports

SMC's gross profit remains constant despite the fact that sales have dropped in this period. This is because the gross margin has improved from 15% in 2001 to 19% in 2004. This is the direct result of changing product mix. Higher gross margin products were introduced to the market. The net profit improves due to better-cost control and efficiency improvement.

3.6.4 Product mix

Table 13 SMC's product mix changes 02-04

Categories	PERCENTAGE OF SALES IN 2002	PERCENTAGE OF SALES IN 2003	PERCENTAGE OF SALES IN 2004
T-SHIRTS	58.7%	53.2%	57%
BREWERY IN CASE DEAL	6.8%	11.3%	1.5%
SPORT SHIRTS	12.6%	13%	14.8%
JACKETS & OUTERWEAR	5.0%	3.5%	5.3%
FLEECE	9.7%	13.8%	16.2%
DRESS SHIRTS	5.6%	4.5%	4%
DISCONTINUED	0.9%	0.2%	0.3%
TANK TOPS	0.3%	0.2%	0.3%
SHORTS	0.2%	0.1%	0.4%
TOWELS	0.2%	0.2%	0.2%
	100%	100%	100%

Data source: SMC's internal reports

SMC's increased gross margin is due to the change of product mix. The sales decrease is primarily due to the loss of the "brewery in case deal" program and lower sales on the basic T-shirt. As indicated earlier in the paper, brewery companies had purchased millions of T-shirts from SMC but do not buy T-shirts anymore due to their promotion method changes. The high margin categories, such as fleece, have increased in percentage of total sales during this period.

4. Key issues facing SMC

The preceding analysis of SMC results in a number of areas of issues those are detailed below. Although SMC is still profitable and the profitability is improving and no immediate pressures are evident to force change, SMC is exposed to major risks and faces strategic issues.

4.1 Lack of growth

SMC's sales have declined dramatically by 28% from 2002 to 2004. It appears that the decrease in sales is due to the loss of orders from brewery companies. It is more serious than that. The sales decline impacts almost every province as indicated in Table 14. Also, the sales decline impacts most of the categories as indicated in Table 13, except the fleece product line. It seems that the sales decline is offset by increased gross margin and well-controlled G&A expenses. It certainly keeps SMC from becoming a stronger company in the market place. The situation posed a threat to the company so the company froze salaries in 2002 and discussed possible downsizing.

Table 14 SMC's sales by 4 provinces 2002-2004

Sales by provinces	SALES	SALES	SALES
	%ofTotal	%ofTotal	%ofTotal
ON	48.5%	45.8%	39.9%
BC	27.3%	26.8%	29.0%
AB	10.5%	10.8%	12.7%
QC	3.7%	4.7%	4.6%

Data source: SMC's internal reports

SMC's market share has shrunk in most of the provinces. The decline in Ontario was primarily due to the lost orders from brewery companies. BC and Alberta have gained in percentage of total company sales. This is due to strong sales representation and merchandiser's coverage. The sales in other provinces remain flat. Although more orders

were processed in 2004, SMC demonstrated a decline in revenue because of price reduction for most of the products and switch of customer buying other promotional products. SMC has introduced the merchandiser program since 2004 but the sales have not improved as planned.

The inability to generate real growth and the lack of explicit expansion plans by SMC puts it in a vulnerable position. Other players in the industry might have stolen SMC's customers, thus increased their market share. Furthermore, distributors from US may enter into the market. SMC must develop a plan to defend its position and be stronger through growth.

Even though SMC is a cost leader, it does not sell products at the lowest prices in the market. Sometimes, SMC matches competitor's prices depending upon the situations.

4.2 Cost reduction opportunities

The following analysis is based on the numbers on statement of income in 2004.

The cost of sales accounted for 81% of sales. The cost of sales has two components, the unit price and the unit cost. Over the years, the unit prices of major categories have dropped, as illustrated in Table 15.

Table 15 Average unit prices by 4 categories 2001 - 2004

Categories	Average Price 2001	Average Price 2002	Average Price 2003	Average Price 2004
T-SHIRTS	3.12	3.11	2.84	2.53
PREMIUM FLEECE	13.28	14.14	13.72	14.21
JACKETS & OUTERWEAR	30.34	33.31	30.29	31.91
SPORT SHIRTS	24.03	23.24	24.74	24.20

Data source: SMC's internal reports

Reducing unit cost seems to be the only way to improve the gross margin performance.

Salaries and benefits accounted for 46% of total G&A expenses, rent and utilities for 16%, bank charges and interest for 7% and interest on loans from related parties for 4.5% respectively. Can SMC further improve its efficiency on order processing so that less labor is required or implement more flexible labor force schedules to reflect the seasonality of sales? Can SMC keep reasonably lower inventory levels so that less warehouse space and capital is required? As a result, less bank charges and interest needs to be paid.

4.3 Lack of in-depth business intelligence and market research

The majority of the industry consists of private companies. Finding industrial information by formal channel is difficult. No financial report is published or shared. Like everybody else, SMC is in a position to compete in the market with very little information. This results in lack of in-depth business intelligence internally in the company. Apparently, this may be the main reason that SMC could not develop effective growth plans. Which geographical areas should SMC focus on? What products should SMC introduce to the market?

Even worse, SMC does not have an effective method to collect the industrial information, such as market research. Even though SMC uses focus groups for some campaigns, it might have effects on small geographical areas but very little effect on serving 15,000 customers. The overloaded marketing department does not have enough resources to design or conduct market researches. Therefore, SMC is vulnerable in finding directions to grow and lacks speed to adjust to changing market interests.

4.4 Improvement on information technology

SMC relies heavily on its distribution resource planning system to process orders, replenish stock, manage inventory and collect money. The system has been customized according to SMC's operations. This highly customized system becomes very difficult to integrate with accounting software or website. Data are duplicated in different systems that make the synchronization of the data extremely difficult. It requires very special skills to maintain the system. Only one external consultant has been identified to manage the system, and the consultant is about to retire soon. Whether to move to a mainstream distribution resource planning system or continue to maintain the current legacy system places SMC in a vulnerable position. On one hand, SMC wants technology to provide competitive advantages to the company. On the other hand, the limitation of the current system stops SMC from achieving its goals quickly.

5. Strategic Recommendations

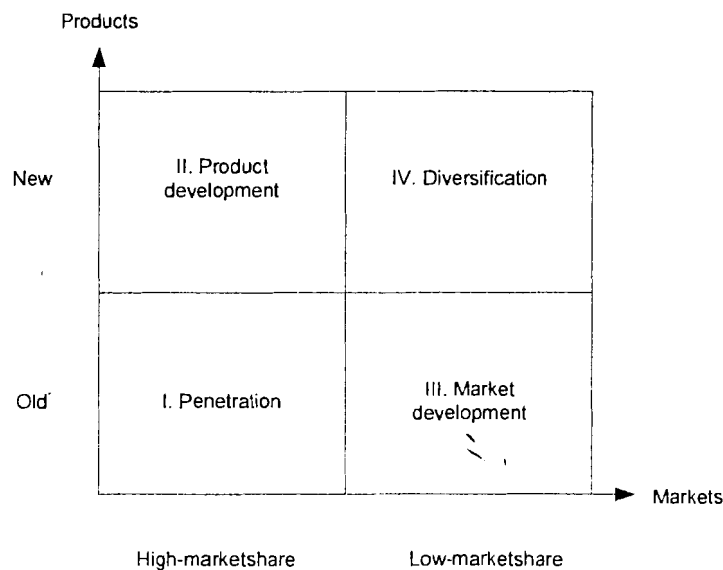
The followings are strategic recommendations for SMC to address the issues it faces.

5.1 Growth

Continuing with the status quo could result in losing key personnel, especially in sales and customer service teams, because compensation is based on sales and growth. If these key personnel leave and, even worse, work for competitors, this will lead SMC towards a difficult situation and SMC will possibly lose one of its competitive advantages. This once happened a few years ago. A sales manager left the company and joined a competitor. His departure affected SMC's business in the areas where he used to manage. Continuing with status quo is not an option for SMC.

SMC should focus on product development (quadrant II) and market development (quadrant III) in order to achieve sustainable growth (see Figure 11).

Figure 11 Strategies for growth matrix



Source: Bukszar, EMBA Strategy Seminar – Spring 2005, by permission

5.1.1 Product Development

By introducing clothes with new materials or features, SMC is able to attract customers. A recent example was that SMC introduced PING golf shirts with UV protection materials. This feature is particularly important for frequent golfers, because skin cancer becomes a more and more serious concern. As such, SMC should be able to enter into that niche market of golf apparel, which is a new area to SMC.

New product lines fuel growth. This allows SMC to enter an established market with new product line offerings. The introduction of work-wear was another good example. Since the introduction, SMC has attracted new customers who deal with construction industry and other manufacturing industry in the existing market. Without compromising the existing customers and product offerings, SMC gains extra sales from this new product line by minimal marketing efforts. SMC should continue to develop new product lines, such as police uniforms, school uniforms etc.

The introduction of the lady T-shirt was a great success in addition to the existing T-shirt product line. Traditionally, male consumers dominate the T-shirt market. Some uni-sex T-shirts is also good for females. By introducing the lady T-shirt, a nicer design and cut for ladies, SMC attracts female consumers. As such, the T-shirt product line is enriched and additional sales are gained. The introduction of companion styles of golf shirts is another good example. Instead of buying one golf shirt, people are buying two shirts in companion styles. SMC should continue to seek opportunities to introduce additions to existing product lines.

The increase in gross margin indicates that SMC continuously seeks opportunities to reduce cost. Developing the Brinell® product lines was a good example. Brinell® is an

Indian apparel producer who has a marketing and sales representative office in Vancouver. Jointly with Brinell®, SMC successfully sources mid-range golf shirts, jackets and outerwear from a low cost production region – India. While maintaining the same style and quality, Brinell® has a much lower cost advantage. As such, it greatly helps to improve SMC's gross margin performance. In this price sensitive market, low cost advantage keeps SMC competitive in the market. SMC should continue to develop more low cost suppliers in Southeast Asia, especially in China and India.

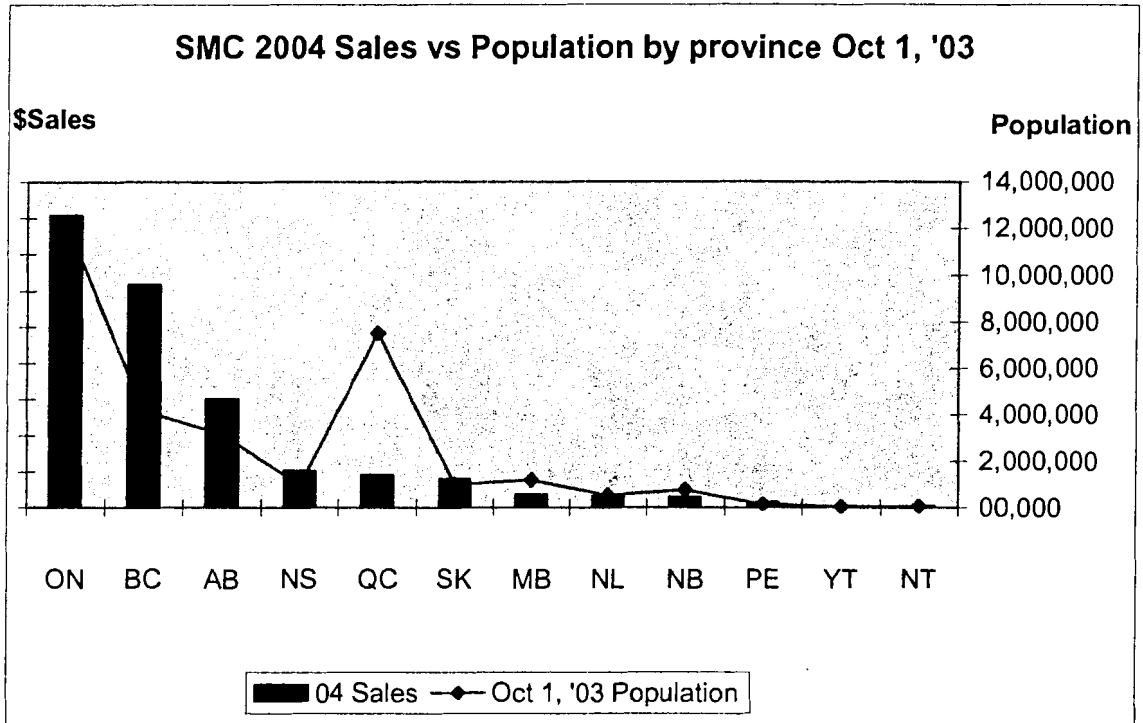
SMC should obtain exclusive distribution rights for more products. Exclusive distribution allows suppliers to maintain control over the service level and outputs offered by the distributors. By granting exclusive distribution, the supplier hopes to obtain more dedicated and knowledgeable distributors. By getting exclusive distribution, the distributor hopes to get great brand recognition and higher gross margin by charging exclusive prices. It appears to be a win-win solution for SMC and PING when analyzing PING's exclusive distribution. On one hand, SMC is compliant with PING's rules of not distributing the products to the sex, drugs and alcohol related places and also promotes its healthy brand. By exclusive distributing PING®, SMC charges higher prices than other brands of golf shirts. On the other hand, PING does not need to deal with or establish its own selling channels because it uses SMC's existing network. SMC should seek more opportunities to capitalize on the exclusive distribution of well-recognized brands. As such, SMC will be the monopolistic distributor for those products in Canada.

SMC should conduct a complete and intensive cost benefit analysis for any new products introduced. As such, this will get SMC away from its traditional "guess work" on product selection.

5.1.2 Market development

Identifying potential market allows SMC to grow. The following analysis is based on SMC's sales in 2004 and the population by provinces as of Oct 1, 2003 as indicated in Figure 12.

Figure 12 SMC's 2004 sales vs population by province as of Oct 1, 2003



Data source: SMC 's internal report

Province	ON	BC	AB	NS	QC	SK	MB	NL	NB	PE	YT	NT
Oct 1, '03 Population	12,280,731	4,158,649	3,164,400	936,878	7,503,502	995,003	1,164,135	520,170	750,460	137,941	31,371	42,040

Data source: <http://www.canadainfolink.ca/charttwo.htm>

Expanding to Quebec is the first priority for market development. Quebec is the second most populous province, but SMC's sales in Quebec are less than \$2 million or ~10% of that in Ontario. Quebec is the home territory of Techno Sports Inc and many other local distributors. SMC will face a strong challenge not only commercially but also culturally. Entering into Quebec means SMC has to produce all its catalogues,

promotions materials, invoices and computer systems bi-lingual. Moreover, SMC needs to hire a French-speaking sales and customer service team. That increases SMC's operating cost. However, conservatively speaking, Quebec is potentially a \$10 million market for SMC simply based on the population. There is no reason for SMC not to enter into this market. Initially, SMC only needs to set up its sales, merchandisers and customer service team to serve the province of Quebec. The Mississauga warehouse is not too far away from major cities in Quebec, therefore, it is not necessary to set up another warehouse in Quebec. This will minimize the startup cost. Management should establish a long-term plan of entering into that market.

SMC should conduct market research by using a customer focus group to understand what the Quebec market needs before making the decisions of launching which products into the new markets. There are a few factors that influence buyer behavior. The buyer's characteristics and decision processes lead to certain purchasing decisions. SMC's task is to understand Quebec customers' buying behavior by analyzing its influence by cultural, social, personal and psychological factors. People in Quebec are recognized as a different cultural group from the rest of the English-speaking societies. By conducting market research, SMC should understand that different ethnic and demographic niches do not always respond favorably to mass-market advertising or product offerings. People in Quebec might be interested in different styles of clothes with different designs, colors or materials. SMC's current product offerings might not satisfy Quebec customers. Moreover, SMC should study the other three factors of social, personal and psychological factors in order to establish an entire marketing plan. In order

to improve market research abilities, SMC should actively look for new technologies and external market research companies to support this initiative.

SMC should use slow penetration to enter into the new market. It is SMC's tradition not to spend a lot on marketing or promotion. Slow penetration will work without the needs to spend much money on promotion to enter into the market. SMC should use the strategy of "test-the-water-as-it-goes" to test in a small segment of the market by offering selective product lines.

SMC should continue to roll out its merchandiser program in order to expand its coverage to identified territories and increase the frequency of visiting existing customers and create new customers. The roles of merchandisers are different from those of salespersons. Primarily, merchandisers are required to visit as many customers as possible and as frequently as possible, to help customers display SMC's products and get feedback from the market place. Usually, customers buy from distributors who visit them or sell directly to them. SMC realized this issue and could not wait for the natural growth of the market reactively. Therefore, the merchandiser program was set up to expand SMC's coverage and increase its presence, especially for those non-urban areas that are easily forgotten. Currently, SMC has hired merchandisers to look after Alberta, Saskatchewan, Ontario and Quebec. There are many more territories to be covered. SMC should roll out the program to every province quickly to be the first mover in the market. No other distributors have this plan at present. If the program is executed properly, SMC should be able to steal customers from competitors by enhancing the program. To make the program successful, SMC should set up specific targets and measurements for the merchandisers. The goal is to visit existing customers to get their feedback to improve

SMC's products and services and to create new customers by introducing SMC as a great active-wear distributor. The whole company should support this program by aligning its primary and supporting activities. It is also a great way to collect customer feedbacks and complaints. As discussed earlier in this chapter, one effective way to retain customers is to make it easy for them to communicate and complain. Once national coverage is established, SMC could reposition itself as a great service company with national merchandiser's coverage.

In addition, more friendly designed and easy to use sales tools should be developed to help customers to sell SMC's products. Through improving sales tools on SMC's website, SMC should be able to offer more automated tools for its customers, such as promotional flyers wizards and catalogue wizards. Without investing on flyer design and trainings, customers can design and customize the promotional flyers and send them to their customers via fax or email. Instead of showing their customers a full catalogue, customers should be able to customize and select a portion of SMC's total product offerings and make it into a mini catalogue. As such, SMC's customers will have better focused products to offer.

5.2 Increased Efficiencies on Order Processing

SMC should continue to shorten the *order-to-payment cycle*, that is, the elapsed time between an order's receipt, delivery, and payment. This cycle links to all the departments that perform primary activities. The longer this cycle takes, the lower a customer's satisfaction and the lower the company's profits will be. In order to improve efficiency of order processing, SMC should review its current measurements and prepare criteria for the Perfect Order. Perfect Order could be a measurement that includes on-time

delivery, order completeness, picking accuracy, and billing accuracy. Any imperfect order will likely lead a customer to drop the distributor. SMC should review order processing in order to improve Perfect Order rate.

At the same time, SMC should utilize its technology advantage to offer real-time inventory and order processing on-line. As such, customers can order products from SMC 24x7. Also, effective communication tools should be available to customers, such as order status inquiries and emails, shipping tracking number etc. By ordering online, customers can receive the same services as ordering by phone, this provides customers great flexibilities to place orders based on their own schedule. This will also save SMC on cost per order and attract more customers who have busy schedules.

Warehousing

The warehouse team can gain efficiency not only by improving inbound and outbound logistics, but also by improving the planning process. Different product mixes are sold to different regions. SMC should evaluate what products to store in which warehouse in order to reduce the warehousing and inventory redundancy costs. Consideration of the number of stock keep units, and stocking locations are to meet customer demand is important to keep the warehousing and inventory cost low. Is the Mississauga warehouse big enough to support the future growth in a Quebec market? Are the current warehouse layouts efficient to pick, pack and ship processes? SMC should continue its continuous process improvement task.

Inventory

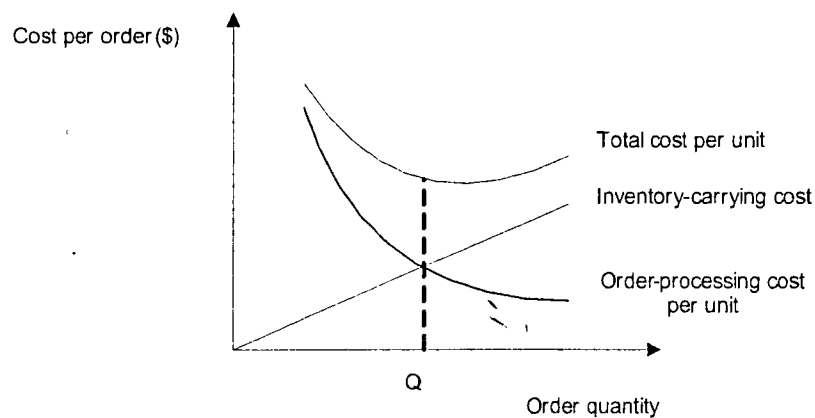
The inventory level represents a major cost, 66% of assets in 2004, to SMC. Inventory cost increases at an accelerated rate as the customer service level approaches

100 percent. Salespeople always would like the company to carry enough stock to fill all customer orders immediately. Management needs to determine how much sales and profits would increase as a result of carrying larger inventories and promising faster order fulfillment times, and then make a decision. SMC should review its inventory decision-making on when to order, how much to order and which warehouse to replenish.

When to order requires SMC's Procurement Department to review at what stock level to place a new order. As discussed in earlier chapters, SMC uses complex but direct worksheets to keep track of the inventory level. The critical point is to balance the risks of stockout against the costs of overstock. The material requirement planning system, which is presently being developed, will help to simplify this process.

How much to order requires SMC to balance order-processing costs and inventory-carrying costs. The optimal order quantity can be determined by observing how order-processing costs and inventory-carrying costs sum up at different order levels. Figure 13 shows that quantity Q is the optimal quantity to order. SMC should evaluate the effectiveness of using this concept.

Figure 13 Determining Optimal Order Quantities



Based on: Kotler, Philip. Marketing Management, 11th edition, NJ: Prentice Hall, 2003, p.557

SMC also should treat inventory items differently. The slow-moving items should be kept in a central location while fast-moving items should be kept in the locations that are closer to customers.

Delivery

Delivery is the last step before customers receive the products. The delivery effects product pricing, on-time delivery performance, and the condition of the products when they arrive. Currently, SMC uses UPS and Purolator as the two main carriers to ship the products. SMC should balance speed of delivery and the cost of delivery when choosing transportation methods in order to maintain service commitment of 1-3 days of delivery to anywhere in the country. A complete package of information along with the delivery should be provided to customers. This will minimize customers on inquiry to their shipment status.

5.3 Collecting business intelligence and marketing research

Market research is SMC's weakness. SMC should conduct more market researches to address specific problems and opportunities in the market.

SMC can use the services of a marketing research firm or conduct researches in creative and affordable ways, such as:

1. Hiring students who have marketing research background to design and carry out the research. Since SMC has a budget to hire co-op students, this is a great way to get the marketing research done on a project basis.
2. Using the Internet. www.zoomerang.com is a great website to conduct all kinds of surveys. SMC can collect considerable information by properly designing surveys. The powerful analysis tools are also provided. A survey is

a very cost-effective way to do marketing research but the response rate might be low.

3. Checking out rivals. Getting information from customers and suppliers on what SMC's rivals are doing is also another way of collecting information.

SMC should find different marketing research tools for different purpose. By doing so, SMC can focus on key issues and maximize the opportunities to grow its business and improve profitability.

A central knowledge base should be set up to share all these information with relative departments. Then decisions are made based on symmetric information.

5.4 Technologies advantages

SMC's highly customized distribution resource planning system is good enough to support the primary activities. Due to the technology limitations, this DRP system is difficult to integrate with other software packages, such as accounting software and on-line ordering. SMC has to duplicate multiple database systems and ensure they are synchronized. This creates great challenges for the IT team. For the long-term, SMC should evaluate other DRP systems developed on the latest technologies that integrate primary and supporting activities. The new system will bring SMC greater technological advantages.

The information technology's first priority is to offer real-time inventory and on-line ordering while integrating to backend DRP system. Also, more advanced and automatic sales and marketing tools should be developed in the new website development. As discussed in the earlier chapters, on-line ordering will gain extra sales for SMC by attracting those customers who have different or busy work schedules. Real-time

inventory and order status inquiries will increase customers' confidence to use the website. More powerful sales and marketing tools will help customers run their promotions, and demonstrate their products easily with low costs. By helping customers grow their business, SMC will find opportunities to sustainable growth.

5.5 In conclusion

SMC focuses on increased profitability and growth while maintaining its position of being the best service distributor in the industry.

This chapter has provided a detailed overview of what SMC should do to maintain its competitiveness in the market. These recommendations provide a framework to begin the process and are subject to change in response to product, market and competition changes that take place all the time. Each of the identified recommendations on its own is not enough to drive the cost based strategy. Combined, however, the whole of these recommendations is greater than the sum of its individual parts.

SMC should always focus on developing and retaining its valuable people who are capable to build this company to greater successes.

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