Diversification or Concentration: Explore the Global Sourcing Strategy of U.S. Apparel Firms

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Background: The rising sourcing cost is regarded as one of the top business challenges facing U.S. apparel firms in recent years (Ha-Brookshire, 2014; Lu, 2015). To control sourcing cost, theoretically companies can choose to either explore new sourcing opportunities from lower-cost regions or reduce the number of suppliers to take advantage of the economies of scale (Gerri & Frederick, 2010; Jin & Kang, 2013). However, which strategy in practice is more preferred by U.S. apparel firms and what factors affect companies' choice remain largely unknown. To fulfill the research gap, this study intends to conduct an empirical investigation. Findings of the study can make important contributions to our understanding of apparel firms' sourcing behavior in today's turbulent market environment. The findings can also be of great value to industry leaders for sourcing decision makings and government agencies for related trade policymaking.

Literature review: Based on the resource-advantage theory of competition and existing literatures, theoretically an apparel firm could benefit differently from either diversifying or concentrating their sourcing base:

Benefits of sourcing diversification	Benefits of sourcing concentration
• To fully take advantage of resources around the globe • To take advantage of cost-saving benefits under newly-implemented free trade agreements or trade preference programs • To support new market entry • To increase flexibility in sourcing	• To take advantage of economies of scales • To strengthen the relationship with key-suppliers • To consolidate limited resources and improve the efficiency of existing supply chains

References: Gerri & Frederick, 2010; Ha-Brookshire, 2014; Lu, 2015; Ed.Pickles, Plank, Staritz & Glasmeier, 2015)

Based on the respective benefits of sourcing diversification and concentration, this study proposes two hypotheses: *H1*: Both the sourcing diversification and the sourcing concentration strategy could help an apparel firm control sourcing cost. *H2*: Apparel firms in larger size, implying a more global-based operation, are more likely to choose the sourcing diversification strategy than the sourcing concentration strategy.

Data and methods: Firms on the list of *the Apparel Top 50 for 2015* were selected as samples for the study, because the list covers the most influential players in the U.S. apparel industry (Speer, 2015). The sourcing practices and financial performance of each firm from 2011 to 2014 (the most updated one available) were collected from their respective annual report. Whether a firm has adopted a sourcing diversification strategy or sourcing concentrating strategy during the examined period was coded based on: 1) the reported number of vendors used; 2) the reported sourcing portfolio by region. Apparel firms which did not release their annual reports or did not disclose their detailed sourcing practices in the annual report were excluded from the analysis. Altogether, 33 companies with valid sourcing and financial information were used in the study.

<u>Results and discussions</u>: First, results show that both the sourcing diversification strategy (n=22, 66.7%) and the sourcing concentration strategy (n=11, 33.3%) were commonly adopted by U.S. apparel firms from 2011 to 2014. During this examined period of time, the gross margin percentage, which reflects a firm's performance in controlling cost of goods, slightly increased by 0.64 percentage point on average for apparel firms which diversified their sourcing base but dropped by 0.73 percentage point on average for those concentrated their sourcing base. However, result of the Mann-Whitney test shows that the apparent different performance is not statistically significant (p=0.441), suggesting sourcing cost of U.S. apparel firms can be controlled by adopting either of the two sourcing strategies (*H1* is supported). Second, a logistic regression was performed to ascertain the effects of firm size (measured by the value of net sales in 2014) and firm's business strategy (measured by gross margin percentage in 2014) on the likelihood that either the sourcing diversification or the concentration strategy would be adopted. The regression was statistically significant, $x^2(2) = 0.024, p < 0.05$. With every one $billion increased net sales, U.S. apparel firms will be 63.2% more likely to adopt a sourcing diversification strategy (*p=0.05). H2* is supported. Increasing gross margin was also suggested weakly associated with an increased likelihood of adopting the sourcing diversification strategy (*p=0.06<0.10).*

<u>Implications and future research agendas:</u> Findings of the study have several important implications. First, results of the study confirm that U.S. apparel firms are actively adjusting their sourcing base as a means to control sourcing cost and respond to the changing business environment. Second, findings of the study suggest that U.S. apparel firms are becoming more diversified in their choice of sourcing strategy. This calls for more attention to be given to apparel firms' sourcing practices and emerging sourcing models at the micro-level. Future studies may include more U.S. apparel firm into the analysis. Higher-quality first-hand data collected through survey and interview may help further explore the sourcing strategies that are emerging in the U.S. apparel industry.

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