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Youngone's Sustainable Growth: Business Diversification from Manufacturing to Retailing*

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INTRODUCTION

The business environment is tough. There was never a time when it was not tough. We have overcome whenever we face challenges. Difficulties are given to overcome.

— Kihak Sung, President of Youngone

In June 2021, Kihak Sung, President of Youngone, sat in his office in Seoul, reading an article that featured Youngone's outstanding financial performance. While most South Korean fashion companies were struggling due to the pandemic, Youngone showed a surprising performance, recording sales of about US$2.4 billion in 2020.[1]

Youngone is a KOSPI 200-listed South Korean sportswear manufacturing company that has more than 50,000 employees worldwide. Through the original equipment manufacturer (OEM) business, Youngone became one of the most successful manufacturing companies in the global fashion industry. Youngone manufactures garment products sold under the buyers' brand names. Many well-known Western apparel brands such as The North Face, Polo, Patagonia, Nike, and L.L. Bean are Youngone's buyer companies.

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The American apparel and footwear company, VF Group, which owns more than 30 brands including The North Face, is also Youngone's customer. The VF Group has approximately 1,400 vendors worldwide. Among them, Youngone is the most important partner, accounting for nearly 30% of the total sourcing portion.

Youngone's sales increase, despite the devastating effect of COVID-19 on the OEM companies, was due to its retail business. In particular, the Swiss sporting goods brand, Scott, played an important role. Youngone acquired Scott in 2015. The journey of the acquisition was not easy. Youngone acquired 20.1% of Scott's shares in 2013 and another 30% in 2015.[2] However, due to the delay in the anti-trust filing process in Europe, the acquisition took much longer to complete.

For a successful OEM company running a stable business, entering a retail business that requires significantly different capabilities from its current core competencies is a risky challenge. However, as the manufacturing industry environment shifted rapidly, Kihak Sung needed to find a new driver that can help attain sustainable growth. Thus, he made a strategic decision and Youngone started to expand into retailing.

As Scott is driving sales growth while most manufacturing companies are suffering from the pandemic's impact, this strategy seems to pay off currently. However, as the pandemic continues, the business environment is highly unstable and Youngone is encountering many challenges in which it has to both normalize manufacturing business and build competency in the retail business.

A HISTORY OF EXCELLENCE IN MANUFACTURING

Youngone was founded in 1974 by Kihak Sung, who developed a vision for an apparel sourcing company while arranging business meetings between overseas buyers and South Korean factories at an apparel export firm. Youngone grew through an OEM system in the 1970s and 1980s.

In an OEM system, a manufacturer produces finished goods according to the detailed specifications of a buyer company. The buyer company sells and distributes the finished goods under its own brand name. An OEM system is a cooperation between suppliers and buyers to maximize efficiency while minimizing costs in the production process (refer to Exhibit 1).[3]

In the 1960s and 1970s, labor costs in South Korea were very low. With a cheap and skillful labor force, South Korea achieved cost competitiveness in the labor-intensive textiles and apparel industry, which led to economic growth. To accelerate economic growth, the South Korean government adopted a manufacturing-focused, export-oriented policy. The textiles and apparel sector accounted for more than 40% of the total exports from South Korea in 1971. In the mid-1970s, the global textile industry, which had long been centered around North America and Western Europe, shifted its base around the newly industrialized economies in East Asia (i.e. Hong Kong, Singapore, South Korea, and Taiwan) with abundant cheap labor. Until the mid-1980s, South Korea played a pivotal role in the global textile manufacturing industry.[4] Youngone grew alongside this economic growth of South Korea.

In an OEM system, buyers provide skills and technical training to manufacturers, as manufacturing proceeds according to buyers' specific instructions in terms of quality inspection, packing, shipping, etc. In this process, advanced manufacturing technologies are transferred to manufacturers. In the early days, Youngone's key partner was the American sportswear brand White Stag, whose main product was high-functional skiwear. From White Stag, Youngone acquired the technical skills required to make high-functional sportswear, such as down jackets, coats, and skiwear. In the 1980s, Youngone became recognized as a solid sportswear manufacturing company possessing high technical skills. Youngone continuously developed manufacturing technologies and finally produced Gore-Tex for the first time in South Korea in 1986.

SHIFTING BUSINESS ENVIRONMENT AND STRENGTHENING OF MANUFACTURING CAPABILITIES

Crisis

Youngone grew remarkably until the early 1980s, when the amicable environment began to turn around. In the 1960s, the South Korean government's policy for economic growth focused on the light industry to which most of the textiles and apparel businesses belonged. However, in the 1970s, the South Korean government started to foster the heavy and chemical industries to improve its industrial structure. With these changes, the share of the textiles and apparel sector in the South Korean manufacturing industry declined drastically. The largest share in the South Korean manufacturing industry, which had been occupied by the textiles and apparel industry in the 1960s, was taken by the chemical industry in the mid-1970s, and the metal industry took this mantle after the mid-1980s. The export structure also changed accordingly. The export growth rate of textiles and apparel products plummeted from 41% in 1971 to 29.1% in 1975 and to 25% in 1990.

Moreover, in the late 1980s, the labor movement invigorated, facilitating the organization of labor unions. Wages increased by approximately 20% every year. Youngone, which relied on cost-competitiveness using cheap labor, struggled with surging labor costs and shortage of workers. Meanwhile, China and Thailand entered the market with cheap labor, which deepened competition in the global market. As raw material costs soared due to the second oil shock of 1979, the global business environment became hostile. The Multi-Fiber Arrangement (MFA), which was established in 1974 in pursuit of protectionism, also imposed quotas, limiting exports to Western countries. Under these harsh circumstances, Youngone's sales growth rate, which recorded a high number so far, began to decline. Kihak Sung, who was a board member at that time, believed in the need for new offshore production bases in such circumstances to buffer escalating costs and have safe havens to avoid quota regulations. However, the other board members objected, and hence, he took over other board members' stakes and became the CEO to execute his globalization plan. In 1988, an initial public offering (IPO) was made, and Youngone went public.

Offshoring

In the 1980s, Youngone actively pursued globalization. Bangladesh was chosen as the first offshore production base. Bangladesh had abundant and cheap labor. In addition, the trade barriers of Europe, where the major buyer of Youngone at the time was located, were much lower for Bangladesh, which allowed to bypass the quota limit. The Bangladesh government's favorable policy of attracting foreign investment was another prime reason. As Bangladesh needed an external economic stimulus, free trade zones were operating at Chittagong and Dhaka, where foreign firms were exempted from tax for 10 years. Bangladesh's exports were growing, and its economy was stable. In July 1980, Youngone invested $150,000 and established a joint-venture company, Youngone Bangladesh Ltd., in Chittagong, with a 49% stake.

However, running an offshore production base was challenging. Bangladesh was in a politically confusing stage. Protests were frequent, interrupting factory work. Lack of infrastructure caused problems in logistics and communication with the headquarters in South Korea. Although labor was cheap, skilled workers were insufficient, harming productivity. The Bangladeshi partner was inexperienced and clumsy, and the cultural differences were significant. To handle these problems, Youngone ended the partnership and established Youngone Ltd. through its own investment of $500,000, and then eagerly deployed localization. For example, it set up space in factories for Islamic prayers. Mid-level managers were hired locally instead of sending staffs from South Korea. Through these efforts, local workers' capabilities were enhanced to operate factories without South Korean managers.

In the 1990s, Youngone diversified production bases across multiple countries. In 1995, new production facilities were established in Qingdao. Qingdao offered advantages to US buyers who were entering the Chinese market by enabling manufacturing and sales to take place in the same region. Youngone continuously expanded to various countries such as Vietnam, Mexico, El Salvador, and Turkey (refer to Exhibit 2). Fashion products are trend-sensitive, and thus lead-time management is critical for OEM companies. Through the diversification of production bases across different countries, Youngone was able to shorten the lead time to retailers dispersed all over the world and strengthened its competitiveness.

Manufacturing Model Diversification

In the 1990s, many Asian firms that once pioneered the OEM system transitioned to the original design manufacturer (ODM) and original brand manufacturer (OBM) systems by developing design capabilities and their own brands. Youngone also diversified its business model into an ODM system. Differentiated from an OEM, an ODM involves both manufacturing and product design. ODMs produce and sell unlabeled products to brand owners, who finalize the products with their packages and labels. The ODM system requires much higher technical capabilities for manufacturers but is more lucrative. By adopting the ODM system, Youngone developed product designs for clients and was able to possess design capabilities.

The next step of Youngone was launching its own brand, which meant transitioning to the OBM system. OBMs distribute and sell products from their own brands. The products might either be manufactured by themselves or sourced by a second company. OBM is most challenging, as it requires great control of all processes in the value chain, including R&D, marketing, and sales. However, it is most profitable because the margin is much higher in the downstream businesses of a fashion supply chain. A typical OEM firm's gross profit margin percentage falls below 20%, while that of an OBM is approximately 30%. In particular, in the fashion industry, the brand margin could reach more than 100%.[5] This highly motivated OEM companies to launch their own brands.

Despite all the manufacturing experiences, Youngone did not have its own brand. Finally, in 1991, Youngone launched its own brand, YOUNGONE, which specialized in functional wear. Having applied all the manufacturing know-how and technology, the quality of YOUNGONE was superior while keeping the price range reasonable. The consumer response was promising. Nine months after launching, the sales reached US$14 million, and in 2013, the annual sales were over US$50 million. YOUNGONE was awarded a fashion quality management prize by the International Textile Newspaper in 2014. In 2016, Youngone reorganized its brand business. By a strategic decision, YOUNGONE was closed and the new brand TAKHI was launched. TAKHI is a lifestyle brand that reflects outdoor sports trends. Youngone has been trying to solidify TAKHI's brand identity by establishing a specific targeting group of consumers aged 35–45. Through active online marketing, the number of nationwide offline stores of TAKHI increased to nearly 70 in one year.

A NEW ATTEMPT FOR FURTHER GROWTH: ENTERING THE RETAIL INDUSTRY

While going through a long journey in the manufacturing industry, Youngone has achieved unprecedented success, occupying a high market share in the sportswear OEM market and reserving a solid reputation as a leading manufacturer. With stable sales and profits, Youngone has acquired the capacity to invest for further growth. However, there was not much potential left in the manufacturing area as it already began employing OBM. Youngone might have chosen to stay in the status quo, but instead, Youngone saw a new opportunity in the retailing area which was growing fast.

Retailing is positioned in the intermediary area between manufacturers and consumers in the fashion supply chain. For ages, manufacturers and retailers have been presumed to have different roles. However, over the past decades, Asian apparel manufacturing companies have achieved remarkable growth and reached a limit in terms of firm size. For them, sourcing and manufacturing were no longer sufficient to fuel further growth. On the other hand, the global fashion retail industry was showing an upward growth trend with increasing sales year after year. In particular, the Asian retail industry was significantly developing with the growth of emerging markets such as China and India.

With this background, Asian companies who raised their funding capabilities from manufacturing expanded their business to retailing through M&As. For example, South Korean sportswear company EXR Korea took over the French apparel brand Castelbajac in 2011. Hong Kong-based Fung Brands Ltd. also acquired the French brand Sonia Rykiel in 2012. YGM Trading, a Hong Kong-based company, took possession of the British brand Aquascutum in 2012, as well. Launching a brand and building up brand equity requires considerable effort and time. By acquiring existing brands with rich brand equity, Asian companies with funding capabilities were able to expand to the retail sector efficiently and quickly.[6]

For further growth, Youngone also entered the retail industry and aggressively invested in global outdoor sports brands from the mid-2010s (refer to Exhibit 3). In 2014, Youngone established Mountain Summit Holdings Ltd. in Seattle and purchased an American outdoor apparel and gear company, Outdoor Research. In 2015, Youngone took over two bicycle manufacturing companies: Bergamont and Scott Corporation. The acquisition of Scott Corporation, which was Youngone's buyer company, was a long-term plan that was conceived in 2013 and received much attention in the global market. The Swiss company, Scott Corporation, produces and distributes bicycles and other sporting goods. The takeover value was reasonable. As Youngone's shareholding reached over 50%, Scott Corporation's sales are marked as Youngone's sales, influencing Youngone's gross sales significantly.

KEY FACTORS OF SUSTAINABLE GROWTH

Continuous Strengthening of Core Competencies

Youngone grew by entering into new areas to create growth opportunities. However, its main business never deviated from manufacturing. Youngone has continuously strengthened its core competencies in manufacturing, improving manufacturing performances. In particular, to stay competitive in the manufacturing business, Youngone has steadily enlarged its product portfolio. Youngone started with sportswear manufacturing, but the manufacturing portfolio was soon expanded to leather goods and knitwear.

In 2009, a footwear manufacturing corporation was established, and shoes were added to Youngone's portfolio. Youngone acquired a New Zealand fabric manufacturing company and a Dutch functional fabric manufacturing company in 2010 and 2011, respectively. Adopting advanced technologies of these companies, Youngone built a fabric production base in Vietnam and manufactured wool products. In February 2013, Youngone issued a global depository receipt (GDR) of US$113.75 million, successfully making an IPO on the Singapore Stock Exchange. From this funding, US$25 million was invested in establishing a company in Bangladesh for handbags and sportswear manufacturing.[7] Another US$23.7 million was invested in the production plants in Vietnam and El Salvador.

Youngone is still eagerly investing in overseas production bases. In 2016, a huge amount was invested in Ethiopia and Uzbekistan to build a textile industrial complex. Recently, in 2020, Youngone established Evertop Textile & Apparel Complex Pvt. Ltd. in India. Though the initiation of operations is being delayed due to the pandemic, India is set to become one of the important production bases going forward.[8]

Through these efforts, Youngone achieved ISO 22301 in 2018, which shows its best practice in risk management. Also, by attaining strong manufacturing competitiveness, more new brands such as the German brand Engelbert Strauss and the Canadian brand Lululemon Athletica were added to the client list.

Consistent strengthening of manufacturing competitiveness is where Youngone's success comes from. Through continuous improvement, Youngone has advanced to possess an optimized and harmonized combination of resources. Advanced technologies and equipment, specialized manufacturing skills and know-how, and highly skilled human resources, among other factors, are the foundation of Youngone's competitiveness, distinguishing it from the competitors.

Synergies from Vertical Integration

Youngone's success is also explained by synergies from vertical integration. The value-creation process in the fashion industry is complicated. A supply chain consists of many stages and involves a variety of firms that play different roles at different stages (refer to Exhibit 4).[9] By launching sportswear brands and acquiring outdoor sports brands and textile manufacturing companies through M&As, Youngone became a global fashion conglomerate that runs diverse businesses, including textile manufacturing, finished apparel goods manufacturing, and brand retailing. It achieved vertical integration from manufacturing to retailing, which created synergistic effects. The fabric manufacturing business secured a stable supply of high-quality fabrics. By directly selling products manufactured in its own factories under its brand name, margins for intermediaries and operational and overhead costs were reduced, ensuring cost-competitiveness. This synergy was possible since Youngone strategically expanded into areas where it could capitalize on its core competencies. It gradually achieved vertical integration and nurtured maximum opportunities in stages, successfully making synergies. This approach led to cost savings and an increase in the ROI without adverse effects on and disruption of its core business.

In a rapidly changing fashion industry, vertical integration is often employed as a strategy to efficiently accelerate the growth of fashion companies. Li & Fung, which is evaluated as one of the most successful global conglomerates in the fashion and textiles industry, is a good example. Li & Fung started as a sourcing agent in Hong Kong in 1906. It provided Western buyers with customized manufacturing programs by linking and coordinating the internationally dispersed manufacturing plants in Asian countries.[10] Li & Fung grew capabilities of coordinating and managing dispersed supply chains and expanded to logistics and distribution businesses. After the 1980s, retailing constituted a substantial share of its businesses, providing diverse consumer goods to the Asia-Pacific region, including Greater China, South Korea, Malaysia, and Singapore. Through the advanced network, Li & Fung managed many fashion brands, such as Cerruti 1881, Gieves & Hawkes, D'URBAN, and Hang Ten. It also operated approximately 600 retail outlets of the convenience store chain, Circle K, and managed more than 200 retail stores of Toys "R" Us. Li & Fung achieved vertical integration and turned into a supply chain manager, involving almost all the processes of a fashion supply chain.

A subsidiary of Samsung, Jeil Industries, also grew through business diversification. Jeil Industries was founded in 1954 by the Founder of the Samsung Group, Byungchul Lee. In the 1960s, Jeil Industries was one of the leading global textile companies with cutting-edge, high-precision spinning technologies. In the mid-1970s, Jeil Industries launched the first South Korean women's fashion brand, La Beaute, positioning itself as a retailer. In 1989, it expanded into the chemical industry by producing home appliance plastic materials. By the beginning of the 1990s, the textiles and apparel business constituted approximately 90% of its businesses. However, after 2000, the chemical business constituted a greater share. In 2014, to improve corporate governance, Jeil Industries was divided into a fashion division and an industrial materials division. Subsequently, the fashion division was merged with Samsung Everland, which manages leisure, resort, and food services. The histories of Li & Fung and Jeil Industries demonstrate the evolution process of a fashion company through business diversification.

THE WAY FORWARD

Youngone has been consistently adapting to changing market environments and increasing value additions. However, the journey was not easy and there are issues remaining. Youngone has to normalize and stabilize its manufacturing supply chain that has been seriously damaged by the pandemic and raise competitiveness in the retail industry.

Due to the risks of business diversification and expansion, an argument that Youngone should focus on manufacturing has always been suggested by the board members. Although the retail business is appealing, without preparation, an expansion into retailing can be burdensome. It might be safe to focus on the OEM business where Youngone's core competency exists. Indeed, cases that went backward from OBM to OEM have been witnessed. The Taiwanese electronics manufacturer MiTAC operated both OEM and OBM, but it reduced the OBM business because OEM was more profitable under circumstances where it had to compete with its OEM buyers' brands. By reducing the share of OBM, it could concentrate on core competencies and remain competitive.

In order not to follow the path of MiTAC, Youngone has to enhance brand management capabilities. For Youngone, which grew in the B2B area, dealing with consumers is a challenge. Based on a deep understanding of consumer behavior, Youngone should improve its marketing capabilities and build strong brand equity. It should enhance agility to quickly respond to changing trends. The nature of the retail business is different from that of the OEM business. The retail business is knowledge-intensive, requiring capabilities that identify and correctly satisfy rapidly changing consumer needs in a timely manner. These are largely different from facilitating an efficient production process within a specific time frame. Beyond the passive role of focusing on fulfillment and completion of the contract with buyer companies, it is required to actively lead consumers and create trends.

A firm's success relies on managing and enhancing core competencies in response to industry changes. By constantly adapting to market changes and creating opportunities, Youngone has created success stories thus far. Having an independent perspective to foresee the future of the firm is essential for industry leadership. President Kihak Sung's leadership and strategic decisions played critical roles whenever Youngone reached its new heights. Youngone is facing a new challenge and the President is again contemplating to find solutions.

ENDNOTES

[1]Jeong-eun Oh, "Ugly duckling Swan' Scott… Youngone trading in a bicycle boom", *Money Today*, July 14, 2021, accessed February 28, 2022, https://news.mt.co.kr/mtview.php?no=2021071412242229089.

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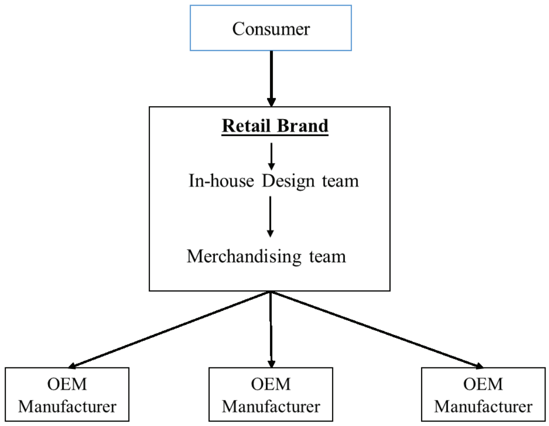
EXHIBIT 1

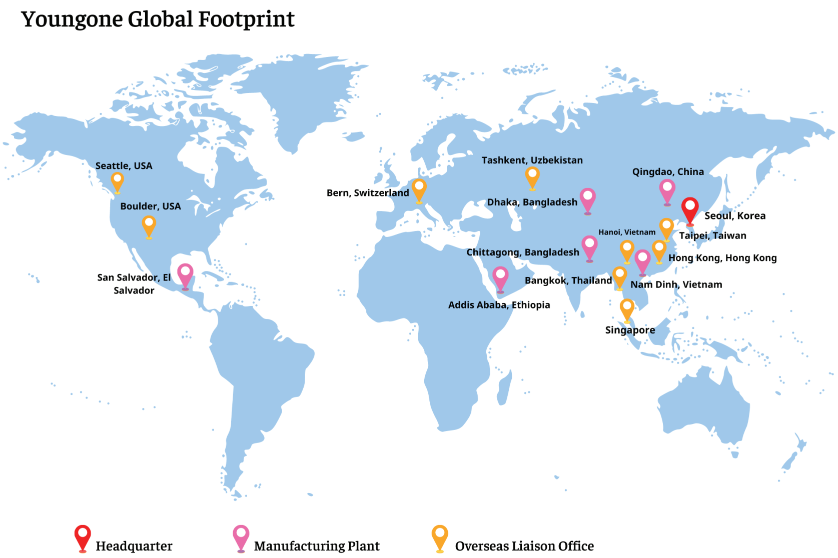
Structure of OEM System in the Apparel Industry



Source: Adapted from Ref. [4].

EXHIBIT 2

Youngone's Global Footprint



Source: Youngone Corporation website.[8]

EXHIBIT 3

Corporate History of Youngone

Year	Key Activities
1974	• Establishment
1976	• Established a down jacket manufacturing facility in Sungnam, South Korea
1980	• Established a joint-venture company, Youngone Bangladesh Ltd., in Chittagong, Bangladesh
1986	• Produced Gore-Tex for the first time in South Korea
1987	• Established Youngone Ltd. in Chittagong, Bangladesh
1988	• Made IPO in South Korea
1991	• Launched Youngone's own brand, YOUNGONE
1995	• Established new production facilities in Qingdao, China

EXHIBIT 3 (*Continued*)

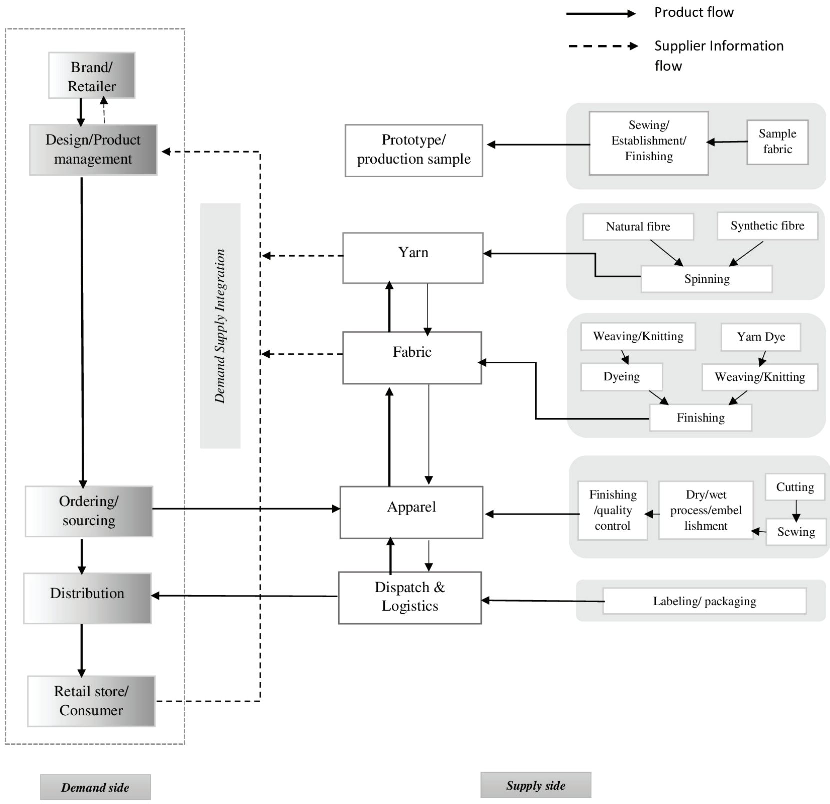
Corporate History of Youngone

Year	Key Activities
2010	• Acquired the New Zealand fabric manufacturing company, Designer Textiles International • Built a wool fabric production base in Vietnam
2011	• Acquired a Dutch functional fabric manufacturing company
2013	• Issued a GDR of US$113.75 million, making an IPO on the Singapore Stock Exchange
2014	• YOUNGONE was awarded a fashion quality management prize by the International Textile Newspaper • Established Mountain Summit Holdings Ltd. in Seattle, USA • Acquired the American outdoor apparel and gear company, Outdoor Research
2015	• Launched new brand, TAKHI • Acquired bicycle companies Bergamont and Scott Corporation
2016	• Invested in Ethiopia and Uzbekistan
2018	• Achieved ISO 22301
2020	• Established Evertop Textile & Apparel Complex Pvt. Ltd. in India

Source: Youngone Corporation website.[8]

EXHIBIT 4

Value Chain of the Apparel Industry



Source: Adapted from Ref. 12.