

## Case 16



# American Apparel: Vertically Integrated in Downtown LA

American Apparel's reversal of fortunes in mid-2010 was sudden and sharp. Since its first retail store in 2003, American Apparel had been one of America's fastest-growing clothing companies with one of the hottest fashion brands. Its retail presence had expanded from the US and Canada to 18 other countries. In 2008, it was placed second (after Nike) in the *Cassandra Report's* listing of "Top Trendsetter Brands" (beating Apple into third place) and CEO Dov Charney was named "Retailer of the Year" in the Annual Michael Awards. The problems began in July 2010 when the company's auditor, Deloitte & Touche, resigned after discovering "material weaknesses" in the company's financial controls. Amidst warnings of declining sales and an operating loss, American Apparel's share price hit a low of 66 cents in September 2010—down from a high of \$16.80 in December 2007. Mounting losses during 2010 resulted in American Apparel breaching the terms of covenants on its \$80 million loan from Lion Capital, forcing American Apparel to issue a bankruptcy warning.

American Apparel's strategic priorities shifted 180 degrees. In 2009, it had targeted annual growth rates of 20% in sales growth and 20–25% in earnings per share over the next few years.<sup>1</sup> Between 2010 and 2012, its emphasis was cost cutting, cash conservation, and financial restructuring. During the latter part of 2010, new, experienced senior managers were brought in, turnaround specialist FTI Consulting hired, and new sources of finance sought.

However, the task of putting American Apparel back on its feet was compromised by disagreements over the sources of American Apparel's problems. While CEO Dov Charney firmly believed that the answer to his company's woes lay in operational improvements to cut costs and boost efficiency, other observers expressed doubts about the viability of American Apparel's strategy. The company had defied the conventional wisdom of the rag trade: instead of outsourcing production to contract manufacturers in low-wage countries, American Apparel had followed a vertically integrated strategy with production concentrated in Los Angeles. Charney believed that the higher costs of manufacturing in the US could be offset by the price premium from superior quality, styling, and image, and by the advantages of speed to market. Critical to these advantages was American Apparel's tight linkage between design, manufacture, marketing, and retailing.

Others saw the CEO's personality and lifestyle as the source of American Apparel's woes. Dov Charney was a self-proclaimed hustler whose workplace behavior and

<sup>1</sup>This case was written by Robert M. Grant with assistance from Ellen A. Drost and Stephen J. J. Guire. © 2012 Robert M. Grant.

frank opinions about and attitudes toward progressive social issues and sex generated controversy, and considerable media attention. Britain's *Guardian* newspaper described Charney as: "this maverick Canadian entrepreneur, who apparently relishes his reputation as a pervert and a libertine."<sup>2</sup> His portrayal as an exhibitionist and sexual predator was reinforced by five sexual harassment suits brought by former employees against American Apparel and its CEO.

## The T-Shirt Business

T-shirts, like denim jeans, are quintessentially American clothing products. About 1.4 billion cotton T-shirts are sold in North America annually with a retail value of about \$20 billion. Originally underwear garments, T-shirts are the most common summer outerwear garment for weekend Americans. The designs and words they carry are important statements of personal identity, indicating affiliation with a sports team, college, political movement, religion, charity, or specific social event. Yet despite the T-shirt's place in American culture, the vast majority are imported (Table 1). Several US manufacturers, such as Gildan Activewear, Hanesbrands, and Delta Apparel own plants in Central America and the Caribbean. A high proportion of imported T-shirts are made from cotton grown in the US, the world's largest exporter of cotton fiber.<sup>3</sup> The average import price of a T-shirt in 2010 was \$2.60.<sup>4</sup> The US garment industry as a whole had shrunk dramatically. When the quota system known as the Multifiber Agreement was created in 1974, 1.4 million Americans worked in the garment industry. By the time it was abolished in 2006, only 270,000 remained.

The US T-shirt market features a wide variety of suppliers. At the wholesale level, blank T-shirts are sold by major suppliers (such as Gildan Activewear, Hanesbrands, Russell Athletic, and Fruit of the Loom) to screen printers that add

**TABLE 1** Imports of knitted cotton shirts into the United States, 2010

Source country	Value of imports, trade categories 338 and 339 (\$ billion)
China	3.54
Vietnam	1.54
Indonesia	1.17
India	0.82
Honduras	0.81
Guatemala	0.64
Cambodia	0.64
Pakistan	0.60
El Salvador	0.53
Mexico	0.51
Total from all countries	13.85

**Source:** US trade statistics.



**TABLE 2** Sales and profits of leading fashion apparel companies, 2011

	Sales (\$billion)	Net income (\$billion)	Return on assets (%)
Gap (US)	14.55	0.83	10.97
Inditex (Spain)	13.80	1.90	15.17
H&M (Sweden)	16.40	2.36	27.46
VF (US)	9.46	0.88	11.27
Next (UK)	5.47	0.64	23.81
Ross Stores (US)	8.61	0.66	20.85
Esprit Holdings (China)	4.35	0.01	(5.66)
Hanesbrands (US)	4.64	0.27	6.58
Abercrombie & Fitch (US)	4.16	0.13	4.29
J. Crew (US)	1.72	0.12	19.10
Gildan Activewear (US)	1.73	0.16	9.43
American Apparel (US)	0.55	(0.04)	(11.97)

**Note:**

Figures in parentheses denote a loss.

**Source:** www.hoovers.com; companies' annual reports.

their own designs or corporate and club logos. At the retail level, many different types of retailer compete: independent specialty stores, department stores, and chains such as Gap, Urban Outfitters, H&M, American Eagle, and Forever 21. The price dispersion is wide: at Sears, a basic T-shirt retails at \$6.99, while at Nordstrom, a Versace limited-edition T-shirt costs \$225. Table 2 shows some leading suppliers of casual clothing.

### Dov Charney and the Development of American Apparel

Dov Charney has been described as a “brilliant entrepreneur,” “an exhibitionist,” a “champion of social liberation,” and a “sleaze-ball.” In some respects he was a traditionalist: emphasizing his Jewish roots, his affection for the *shmita* business, and his desire to recreate America as a manufacturing nation.

Charney's entrepreneurial interest in the garment business was first demonstrated at age 16, when he purchased American-made T-shirts from K-Mart in the US and then drove them to Canada in a U-Haul truck. He sold them outside the old Montreal Forum at concerts.<sup>5</sup> He dropped out of Tufts University during his senior year, borrowed \$10,000 from his father, and moved to South Carolina, where he started his T-shirt business: “Heavy, The American Apparel Company,” which went bust when its contract manufacturer closed down production.<sup>6</sup>

Charney moved to California, where in 1998 he met Sam Lim, an owner of a cutting-and-sewing facility located under a freeway in Los Angeles.<sup>7</sup> Together with an associate of Lim's, the pair formed a company named “Two Koreans and a Jew,” which eventually developed into American Apparel.<sup>8</sup>

## Building American Apparel

Under Charney's leadership, American Apparel developed as a vertically integrated T-shirt manufacturer whose activities extended from knitting cotton yarn, through cutting and sewing, to dyeing and finishing. The main customers were screen printers who printed their own designs and logos and retailed the products. American Apparel's main competitors were the blank T-shirt giants Hanes and Fruit of the Loom. American Apparel differentiated itself by focusing on quality and design. In contrast to the standard loose-fitting, heavy-knit T-shirts, American Apparel offered tightly fitting women's and men's T-shirts with finer thread and a closer knit.

In October 2003, American Apparel opened its first retail store. Charney viewed the Los Angeles store more as an experiment than as a new business: "It's supposed to be a place for some of the intellectuals of the company and customers to hang out . . . It's not a money-maker—let's put it that way."<sup>9</sup> The Los Angeles store was quickly followed by others in New York and Montreal. By the end of 2004, American Apparel operated 34 stores in North America and three in the UK. Charney was totally committed to developing the business. As late as 2005, as CEO of American Apparel, he drew a salary of less than \$100,000: his priority was the long-term development of the company. "We need to dig in deeper, to penetrate the market we're in right now . . . We're building our foundation right now. We want to be the best at what we do, and once we are . . . once we're strong, then we can take on the world."<sup>10</sup> By 2005, American Apparel was the largest garment manufacturer in the US.

In December 2007, American Apparel was listed on the New York Stock Exchange. Fueled by the injection of equity capital, American Apparel embarked upon a new phase of expansion, opening 80 stores in 2008 and entering five new countries (Austria, Belgium, Spain, Brazil, and Australia).

## The Controversial Mr Charney

Dov Charney's key fashion innovation was in turning T-shirts into garments that enhanced the sexual attractiveness of the wearer. However, sexuality played a wider role in the success of American Apparel. In addition to its sexually provocative advertising, the company had a culture that acknowledged the sexual drives of its customers and its employees and embraced sexual conduct and sexual content as part of openness and creativity. If American Apparel's key product differentiation was the sex appeal of its fashion garments, then sexual openness within the company might enhance its ability to design and market these products.

Charney's own contribution to this culture included his wearing American Apparel underwear (and nothing else) while in the office and sexual relationships with his employees. "I'm not saying I want to screw all the girls at work," stated Charney, "but if I fall in love at work it's going to be beautiful and sexual."<sup>11</sup> Between 2005 and 2007, American Apparel faced four sexual harassment lawsuits, three of which were dropped after confidential settlements were reached. The fourth resulted in a wider investigation by the Los Angeles office of the Equal Employment Opportunity Commission into sexual harassment at American Apparel.<sup>12</sup> Charney attributed the lawsuits to disgruntled employees seeking personal gain by exploiting California's litigious culture.<sup>13</sup>

As a result of the lawsuits, American Apparel required employees to sign a document that declared:



American Apparel is in the business of designing and manufacturing sexually charged T-shirts and intimate apparel, and uses sexually charged visual and oral communications in its marketing and sales activities. Employees working in the design, sales, marketing and other creative areas of the company will come into contact with sexually charged language and visual images. This is a part of the job for employees working in these areas.<sup>14</sup>

Charney's overt sexuality was not the only source of American Apparel's legal difficulties. In 2009, American Apparel was found to be employing illegal immigrants and was forced to dismiss 1,500 workers. In 2010, its failure to provide accurate financial information to its auditors resulted in a class action from some of its shareholders.

## American Apparel's Strategy and Operations

By the beginning of 2012, American Apparel was one of the leading suppliers of T-shirts to the US market, both blank T-shirts sold to screen printers and final products supplied under its own brand through its retail stores. Its Los Angeles manufacturing plant was by far the biggest garment-manufacturing facility in the US. This reflected the dominance of imported garments in the US market: most fashion clothing companies concentrated on design, marketing, and distribution, with manufacturing outsourced and offshored.

The distinctive feature of American Apparel was its high level of vertical integration: not only did it undertake most stages of production at its Los Angeles headquarters but also it performed its own design, marketing, and advertising, and owned and operated all its retail stores, even its overseas stores. As a result, American Apparel's business system achieved remarkable speed and flexibility:

Our vertically integrated business model, with manufacturing and various other elements of our business processes centered in downtown Los Angeles, allows us to play a role in originating and defining new and innovative trends in fashion, while enabling us to quickly respond to market and customer demand for classic styles and new products. For our wholesale operations, being able to fulfill large orders with quick turn-around allows American Apparel to capture business. The ability to swiftly respond to the market means that our retail operations can deliver on-trend apparel in a timely manner and maximize sales of popular styles by replenishing product that would have otherwise sold out.<sup>15</sup>

From design concept to the American Apparel store rack, a garment took as little as two weeks. Within a day, a designer could come up with an idea, design a garment, create a pattern, cut it, and have it sewn together. By the evening, the garment could be photographed on a model and emailed for Charney's immediate opinion. If the garment was approved by Charney, it would be prepared for testing in a few American Apparel retail stores. Customer purchases were tracked and analyzed, and if the product were successful, it would be put into full production for shipping to the rest of American Apparel's retail locations.

Table 3 shows financial information for the company.

**TABLE 3** American Apparel: Selected financial data, 2005–2011 (\$million)

	2011	2010	2009	2008	2007	2006	2005
<b>Operating statement items</b>							
Net sales	547.3	533.0	558.8	545.1	387.0	264.7	180.1
Cost of sales	252.4	253.1	238.9	245.9	171.6	138.4	102.2
Gross profit	294.9	279.9	319.9	299.2	215.5	126.3	77.9
Total operating expenses	318.2	330.0	295.5	263.1	184.4	135.1	79.9
of which:							
Selling costs	209.8	218.2	198.5	168.5	115.6	84.0	49.3
Retail store impairment costs	4.3	8.6	3.3	15.6	10.7	6.7	4.1
General and administrative	104.1	103.2	93.6	78.9	58.1	36.8	26.5
Income from operations	(23.3)	(50.1)	24.4	36.1	31.1	9.3	12.2
Interest expense	33.2	23.8	22.6	13.9	17.5	10.8	6.0
Income before income taxes	(37.6)	(74.2)	4.9	21.4	15.3	(0.3)	4.0
Income tax provision	1.7	12.2	3.8	7.3	(0.2)	1.3	0.4
Net income	(39.3)	(86.3)	1.1	14.1	15.5	(1.6)	3.6
<b>Balance sheet items</b>							
Current assets	230.7	216.5	186.3	187.0	152.8	97.0	65.9
of which:							
Inventories	185.8	178.1	141.2	148.2	106.4	76.5	49.3
Total assets	324.7	328.0	327.6	333.0	233.4	163.1	126.2
Current liabilities	143.4	213.2	64.9	74.3	150.7	59.8	40.0
of which:							
Overdraft and current bank debt	52.3	141.8	3.7	3.8	102.8	6.2	1.0
Accounts payable	33.9	31.5	19.7	26.3	21.9	30.1	30.7
Long-term debt	98.9	5.6	71.4	100.0	0.6	52.7	40.0
Total liabilities	276.6	252.9	170.2	196.6	171.5	136.5	100.0
Stockholders' equity	48.1	75.0	157.3	136.4	171.5	11.7	26.2
<b>Cash flows</b>							
Net cash from operations	2.0	(32.0)	45.0	21.2	(5.4)	7.7	1.9
Net cash used in investing activities	(10.8)	(15.7)	(20.9)	(72.2)	(23.8)	(16.9)	(20.9)
Net cash provided by financing activities	12.6	48.2	(25.5)	41.2	44.5	10.6	2.9

**Note:**

Figures in parentheses denote a loss.

Source: American Apparel, 10-K reports, various years.

## Product Development and Design

Recreating the T-shirt as a fashion garment was at the heart of American Apparel's business proposition. Design required careful attention to fit, texture, shape-retention, and color. "We've fashionized and brought fashion to the commodity setting," Charney explained, arguing that his main achievement was "feminizing the



blank T-shirt industry.”<sup>16</sup> Previously, T-shirts were “bulky, one-size-fits-all” garments that were not gender specific. The company explained that:

We employ an in-house staff of designers and creative professionals to develop updated versions of timeless, iconic styles. Led by our chief executive officer, Dov Charney, this team takes its inspiration from classic styles of the past, as well as the latest emerging fashion trends. Our design team will often continue to update or renew a style long after its launch.<sup>17</sup>

American Apparel employed an in-house team of designers at its Los Angeles headquarters. The team didn’t read fashion magazines and paid little attention to catwalk fashion trends. It developed “updated versions of timeless, iconic styles” and took “inspiration from classic styles of the past, as well as the latest emerging fashion trends.”<sup>18</sup> The clothing represented a retro urban-chic style with a 1970s flavor. Designers often went to vintage clothing stores to find inspirations for new designs. The team was led by Dov Charney, who hired each member of the product development department, searching for designers he felt had the “eye for what’s next.”<sup>19</sup> He personally approved all new garment designs. The team took its inspiration from classic styles of the past, as well as from emerging style trends among young adults living in metropolitan cities such as Los Angeles, London, and New York.

By 2009, the company had expanded its product range well beyond the T-shirt. It offered over 20,000 stock keeping units (SKUs), including fabric shirts, dresses, denim jeans, sweaters, jackets, swimwear, babywear, and a variety of accessories, such as bags, hats, scarves, and sunglasses—even sweaters for dogs. American Apparel intended to continue to introduce new merchandise to complement its existing products and draw new customers.

## Manufacturing

American Apparel’s headquarters and main manufacturing facility were housed at the former Southern Pacific Railroad depot in downtown Los Angeles comprising 800,000 square feet of floor space. Dyeing and finishing were at a separate facility in California. Capacity shortage at its Los Angeles facility resulted in American Apparel expanding production to nearby plants in Hawthorne, South Gate, and Garden Grove. The company described its production operations as follows:

Purchased yarn is sent to knitters to be knit into “greige” fabric, which is fabric that is not dyed or processed . . . As of December 31, 2011, our knitting facilities knit approximately 85% of the total fabric used in our garments and had approximately 80 employees.

Knitted greige fabric . . . is batched for bleaching and dyeing and transported to our dyeing and finishing facilities, or other commissioned dye houses . . . As of December 31, 2011, our dyeing and finishing facilities in the Los Angeles metropolitan area dye approximately 99% of the total fabric used in our garments and had approximately 200 employees.

Most fabric is shipped to our primary manufacturing facility in downtown Los Angeles, where it is inspected and then cut on manual and automated cutting tables, and subsequently sewn into finished garments . . . Garments are sewn by

teams of sewing operators typically ranging from five to fifteen operators, depending on the complexity of a particular garment. Each sewing operator performs a different sewing operation on a garment before passing it to the next operator. Sewing operators are compensated on a modified piece-rate basis. Quality control personnel inspect finished garments for defects and reject any defective product . . . As of December 31, 2011, approximately 3,000 employees were directly involved in the cutting, sewing, and hosiery operations at the downtown Los Angeles facility.<sup>20</sup>

An employee's occupation was indicated by attire. Piece workers wore casual clothes of jeans and T-shirts. Supervisors, mechanics, cleaners, and cutters wore T-shirts of a particular color with their position labeled in both English and Spanish on the front. Quality-control supervisors wore purple shirts, line supervisors blue shirts, and mechanics red shirts.

## Retail and Wholesale Distribution

At the beginning of 2012, American Apparel owned and operated 249 retail stores in 20 countries (Table 4). The company described its retail operations as follows:

Our retail operations principally target young adults aged 20 to 32 via our unique assortment of fashionable clothing, accessories and compelling in-store experience. We have established a reputation with our customers who are culturally sophisticated, creative, and independent minded. Our product offerings include basic apparel and accessories for men and women, as well as apparel for children. Stores average approximately 2,500–3,000 square feet of selling space. Our stores are located in large metropolitan areas, emerging neighborhoods, and select university communities. We strive to instill enthusiasm and dedication in our store managers and sales associates through regular communication with the stores.<sup>21</sup>

American Apparel favored locations away from traditional high streets using non-traditional retail buildings with unique environments. Store selection and design were undertaken by Jordan Parnass, a lifelong friend of Dov Charney, and his firm JPDA. Location scouts searched cities for areas that were populated by artists and

**TABLE 4** American Apparel's retail outlets

No. of retail stores, Dec. 31	2011	2010	2009	2008	2007	2006
US	143	157	160	147	105	93
Canada	37	40	40	37	30	26
International	69	76	81	75	47	30

*Source:* American Apparel, 10-K report for 2008.



musicians and for the hangouts of young adults. Once an ideal location for a store was spotted, designers from JPDA researched the "regional flavor" and developed design concepts that incorporated this flavor together with the characteristics of the building's structure.<sup>22</sup> Stores included a converted movie theater and a former auto-garage.<sup>23</sup>

American Apparel's wholesale business sold to about a dozen authorized distributors and over 10,000 screen printers. The latter printed blank products with corporate logos, brands, and other images. Wholesale customers were served by a call center at its Los Angeles headquarters. The company prided itself on the fast turnaround of orders: orders received before 6:30 p.m. were shipped the same day.

American Apparel offered online retail sales through its [www.americanapparel.com](http://www.americanapparel.com) website. There were localized websites for the US, Canada, the UK, Europe, Switzerland, Japan, South Korea, Australia, Mexico, and Brazil.

Tables 5 and 6 show American Apparel's sales, profits, and assets by segment and by country.

**TABLE 5** American Apparel's financial results by business segment (\$million)

	2011	2010	2009	2008	2007	2006
US wholesale						
Sales	156.5	149.0	141.5	162.7	144.5	127.8
Gross profit	42.6	32.0	36.2	46.9	40.1	31.7
Operating income <sup>a</sup>	22.4	11.2	15.5	21.0	19.7	14.2
Identifiable assets	141.7	130.0	153.7	178.1	125.4	n.a.
Capital expenditure	3.6	4.7	4.6	7.1	5.3	4.3
US retail						
Sales	174.8	177.6	191.3	168.7	115.6	80.2
Gross profit	117.2	117.5	136.4	127.9	88.8	63.0
Operating income <sup>a</sup>	(4.7)	(18.5)	17.3	33.5	24.8	11.5
Identifiable assets	84.8	92.9	119.4	98.9	60.0	n.a.
Capital expenditure	4.9	7.6	11.2	30.9	9.3	8.6
Canada						
Sales	61.9	65.6	69.0	67.3	42.4	30.6
Gross profit	35.8	43.3	43.2	40.1	27.1	19.2
Operating income <sup>a</sup>	(3.7)	5.1	14.0	10.8	1.5	3.5
Identifiable assets	30.1	32.9	17.5	17.1	16.5	n.a.
Capital expenditure	0.4	1.5	1.4	4.7	2.0	1.7
International						
Sales	154.2	140.7	156.9	146.4	84.5	46.4
Gross profit	99.3	87.1	104.0	84.2	59.4	31.7
Operating income <sup>a</sup>	8.4	(5.1)	15.3	8.0	14.8	4.7
Identifiable assets	68.0	72.2	37.0	38.9	31.5	n.a.
Capital expenditure	2.1	2.0	3.8	18.3	7.1	2.4

**Notes:**

Figures in parentheses denote a loss.

n.a.: not applicable.

<sup>a</sup> Before corporate expense, interest, other income, and foreign currency adjustment.

**Source:** American Apparel, 10-K report for 2008.

**TABLE 6** Geographical distribution of sales and fixed assets, 2009–2011  
(\$million)

	2011	2010	2009
<b>Net sales by location of customer</b>			
United States	331,290	326,607	332,846
Canada	61,866	65,638	69,983
Europe (excluding UK)	68,130	68,958	81,252
United Kingdom	40,039	32,535	34,214
Japan	14,176	10,716	14,122
Korea	9,749	9,547	9,443
Australia	11,557	9,474	9,105
Other foreign countries	10,529	9,514	8,810
Total consolidated net sales	547,336	532,989	558,775
<b>Property and equipment, at December 31</b>			
United States	49,906	61,754	71,457
Canada	5,041	7,063	8,767
Europe (excluding UK)	4,134	6,257	9,967
United Kingdom	5,091	5,784	6,292
Japan	1,141	1,290	2,827
Korea	308	394	632
Australia	1,146	1,311	1,299
Other foreign countries	671	1,547	2,055
Total consolidated	67,438	85,400	103,310
Total property and equipment	67,438	85,400	103,310

Source: American Apparel, 10-K report for 2008.

## Employee Relations: A “Sweat-Shop” Free Environment

American Apparel summarized its approach to human resource management as follows:

We view our employees as long-term investments and adhere to a philosophy of providing employees with decent working conditions in a technology driven environment which allows us to attain improved efficiency, while promoting employee loyalty.<sup>24</sup>

Rates of pay exceeded the going rates for the job: even the lowest-paid workers earned around double the minimum wage. Workers were offered subsidized health-care for themselves and their families, subsidized lunches, free parking, bus passes, and low-cost auto insurance. There were on-site massage therapists who provided regular services for all employees. Yoga classes were also available, along with a health-and-wellness specialist who provided counseling. Workers could take bathroom breaks at any time and use their cell phones for quick personal calls during working hours. Workers received training to improve their job and management skills as well as English and math classes. The human resources department also assisted employees in completing their tax returns and in opening bank accounts.

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## Marketing and Social Responsibility

American Apparel's approach to marketing was radically different from that of most fashion clothing companies. It developed all of its marketing and advertising in-house. Its advertisements were striking. The photographs used in advertising and promotion were often taken by Charney and other amateur photographers. Models were all amateurs—employees, customers, and friends—who posed without makeup or fancy hair-dos. They did not conform to conventional notions of style and beauty: they often featured skin blemishes and asymmetrical features. Not only are the models natural and ordinary, so too are the poses and locations: American Apparel ads depict young men and women sitting on the floor, lying on beds, or lounging on a sofa. As the *New York Times* observed: the advertisements have a “flashbulb-lighted, lo-fi sultriness to them” looking more like photos on Facebook than ads on a billboard or glossy magazine.<sup>25</sup>

They were also sexually suggestive. In April 2012, Britain's Advertising Standards Authority banned eight images on American Apparel's website it found objectionable. Its objection referred explicitly to the “voyeuristic and amateurish quality to the images which served to heighten the impression that the ads were exploitative of women and inappropriately sexualized young women.”

American Apparel also avoided mainstream media. Its advertising was directed mainly to online sites and alternative newspapers such as *The Village Voice*, *LA Weekly*, and *The Onion*, and online publications such as *Purple Fashion* and *Fantastic Man*.

American Apparel was active in social and political causes. It hired employees from Homeboy Industries, an organization that assisted at-risk youths and former gang members. It was prominent in supporting free trade and immigrant rights. It used its “Made in USA” and “Sweatshop Free” credentials as part of its advertising messages. It also pioneered environmentally friendly clothing, including its *Sustainable Edition* organic cotton line.

## Managing Turnaround, 2010–2012

Measures to stabilize American Apparel's financial position included the following:

- *New senior management appointments* included Marty Staff (previously of Ralph Lauren and Calvin Klein) as head of business development, Thomas Casey (previously Blockbuster's CFO) as company president, and John Lutterell (previously with Gap) as CFO. Following disagreements with CEO Charney, Marty Staff left American Apparel in October 2011. He commented on leaving: “Dov is a one-man band and I don't think I realized how singular that vision is. When I joined, I don't think I realized how actively Dov manages every part of the company—from design to IT to marketing to finance. All roads lead through Dov.”<sup>26</sup> Tom Casey left the following month.
- *Store closures*: A review of the performance and prospects for each retail outlet resulted in a number of store closures. During 2010 and 2011, the number of American Apparel stores worldwide was cut from 281 to 249.

- *Refinancing*: Restoring American Apparel's liquidity position involved renegotiating its loan agreement with Lion Capital, borrowing \$80 million from Crystal Financial LLC at 9% above LIBOR, and raising \$21.7 million from issuing common stock.
- *Cost-cutting measures* included cost efficiencies in raw material purchases, streamlining logistics operations, reducing corporate expenses, improving merchandizing, and rationalizing staffing levels.
- *Increasing sales*: A major initiative by Marty Staff was to expand American Apparel's wholesale business by exploiting its fast-turnaround capability and to grow sales in other retailers' stores. During 2011, American Apparel expanded its sales through London's Selfridges and Paris's Galeries Lafayette. American Apparel also sought to boost retail sales by means of promotional offers, especially through Groupon. Through improving the American Apparel website and the fulfillment process, the company increased online sales: during 2011, online consumer net sales increased by 14.5% to \$24.3 million (US online sales were included in the sales figures for the US wholesale segment).

## Looking to the Future

By spring 2012, American Apparel's financial situation was looking much more stable. Sales for the first quarter of 2012 were 14% above the previous year and Dov Charney expressed optimism over the company's ability to refinance its borrowings at lower rates of interest.

However, no fundamental redirection of American Apparel's strategy had taken place. The company's reports and press releases affirmed its commitment to vertical integration, to continuing to expand its "retail footprint," and to broaden its product range.

American Apparel had demonstrated the market potential for premium-priced, casual knitwear that embodied "urban cool." But was this business model, which rested upon American Apparel's LA-based production facilities, globally scalable? International expansion meant longer supply chains, increased logistical complexity, and increased diversity of customers. The broadening product range added further complexity to purchasing, manufacturing, and distribution. Overall, American Apparel's tightly coordinated, vertically integrated business model was being stretched in multiple directions.

Even if this strategy were sound, American Apparel's capacity to implement it effectively was open to doubt. As several of the new senior management hires had discovered, American Apparel was still Dov Charney's baby and, despite its size and geographical spread, he remained the critical link that held everything together. The enforced pause in American Apparel's expansion had allowed the company to develop its financial, operational, and logistical systems, but did it possess the managerial capacity to cope with a new round of expansion?

## Notes

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