

In Search of Middle Class Economics to Drive Urban Renewal

Jong Lee 18 October 2016

Summary

Social entrepreneurship is increasingly being touted as an important means by which to address a broad spectrum of social challenges, including those plaguing urban communities in decline. Can social entrepreneurs find and scale well-paying private sector employment to drive urban economic renewal? Founded in Hong Kong, Bonham Strand is a branded for-profit social enterprise that seeks to achieve its social mission and sustainable fashion goals by adopting startup and private equity best practices to disrupt the professional apparel industry.

Social entrepreneurship is increasingly being touted as an important means by which to address a broad spectrum of social challenges, including those plaguing urban communities in decline. One chronic and substantial barrier to improving local urban economies is a form of domestic mercantilism where most of the economic benefit generated by local commercial activity is extracted and transferred to other economies, leaving little to no discretionary free cash flow in the local community. To the

extent any local employment is generated, the jobs are typically engineered to be low-wage and low-skill in nature (e.g., Walmart and fast food franchises).

Subsistence wages representing only a small fraction of total revenue are simply insufficient to drive organic economic growth or re-establish resilient middle class ecosystems. Can social entrepreneurs find and scale well-paying private sector employment to drive urban economic renewal?

Our Ongoing Experiment

Founded in Hong Kong, Bonham Strand is a branded for-profit social enterprise that seeks to achieve its social mission and sustainable fashion goals by adopting startup and private equity best practices to disrupt the professional apparel industry. Our business is based on competitively priced, high-value custom apparel for men and women with the objective of generating a majority of revenue from local artisan production and services.

Bonham Strand's commercial model is able to reduce or eliminate significant financial and structural costs and liabilities typical in our industry in order to invest in significantly elevating the long-term skills-based value of local labor and building customer relationships. Bonham Strand's innovative Second Chance platform actively solicits donations of unwanted suits from the community for inspection, merchandizing, re-tailoring and resale of great, customized, pre-loved suits for as little as US\$75.

Second Chance advances sustainable fashion by reducing waste and significantly increasing the useful lifespan and frequency of enjoyment of every suit.

Leveraging Our Social Enterprise Status by Not Emphasizing It

From the outset, the Bonham Strand team committed itself to an ambitious venture capital approach (albeit limited by self-financing) by investing in superior services and products at market-competitive prices backed by a satisfaction guarantee years before revenues scaled sufficiently to generate positive gross profits.

We felt it was strategically essential to take away any commercial reason not to choose Bonham Strand. All other factors being equal, we counted on more customers ultimately choosing us because we were a social enterprise. In addition, as part of our brand investment, we actively championed our social mission and committed ourselves to community outreach. As a result, we grew awareness and goodwill with the community, stakeholders and media without having to spend a significant percentage of revenues on traditional marketing.

The Economic Forensics Behind Your Suit Purchase

When you purchase a suit from a traditional retailer, such as a department store or a "big box" specialist such as

Men's Wearhouse, what is the economic impact to your local economy? Given typical retail apparel margins and excluding applicable sales taxes, it is likely that the purchase of a decent US\$500 suit delivers only about US\$50 (10 percent) of local benefit in the form of low-wage and low-impact subsistence employment. Sadly, the remaining 90 percent of the cash from your purchase is strip-mined from the local economy and distributed to:

- the retailer (New York);
- the brand owner (London);
- the REIT real estate owner (Delaware);
- advertising channels in Silicon Valley, Hollywood and New York; and
- the overseas trading company and/or factory owner.

An Industry Ripe for Revolution

The US\$10 billion North American suit business is an industry poised for disruption:

- The market is dominated by one big box retailer (Men's Wearhouse) and department stores;
- The industry employs about 100,000 people in the U.S. but pays poorly;
- Large lease, capital investment and maintenance costs drive down real estate yields;
- Substantial balance sheet risk for inventory and write-downs are necessary;
- Reliance on long traditional multi-party supply

chains;

- The industry is a major polluter, second only to big oil;
- Industry dynamics and compromises are driving a disposable fashion mindset; and
- Lack of innovation and market diversity are driving earnings growth via consolidation, high marketing costs and expense reduction.

Modern Venture-Funded Online2Offline Variants Not Much Different

Online-only retailers such as Amazon generate almost no local economic benefit. Companies like Vancouver-based Indochino that have evolved their model to establish retail order-taking and measurement locations in major metro areas are becoming extensions of large Chinese manufacturers (their largest investor and now exclusive manufacturer is the Dayang Group). As a “delivered to order” factory-made suit vendor, they are able to keep lower inventory levels and have smaller footprint retail locations but do no better than traditional retailers in substantially increasing the portion of dollars left to circulate in the local economy.

Engineering Competitive Advantage

We engineered Bonham Strand to be a custom product as a service business allowing us to reallocate approximately 20-30 percent of net revenues from traditional and fixed

expenses and 60 percent less balance sheet exposure towards long-term investment in the market value of our team members and customer relationships. At the same time, our Second Chance Program advances sustainable fashion and differentiates us from our competition (both the new suit vendors and the thrift shops) by offering a wide local selection of unique and custom re-tailored options starting at just US\$75, enabling entry-level customers to experience the value of bespoke even before they can afford a new custom outfit.

Bonham Strand was designed from the ground up to offer superior value through industry innovation and reinvention:

- We are a venture startup poised to quickly, nimbly and disruptively offer compelling market alternatives, adaptable to local dynamics;
- Our custom apparel business drives significantly higher revenues per employee and does not require thousands of additional square feet for off-the-rack inventory;
- Lack of pre-made new inventory provides substantial balance sheet advantages while our Second Chance platform offers thousands of in-stock suits in every store;
- Like Warby Parker, we offer greater value through our vertically integrated supply chain;
- Quality custom apparel encourages longer useful lifespans (fewer replacement purchases) and more

frequent use (fewer outfits needed);

- We drive growth through word-of-mouth referrals based on our great service, quality offerings and happy customers. In addition, we build brand awareness and commercial goodwill by serving local communities, not traditional marketing expenditures; and
- While we are committed to embracing technology to enhance competitiveness, our overriding philosophy is to leverage IT to increase the value of human capital, not eliminate it.

As a result of our markedly different approach, we are able to commit far more resources to the long-term investment of our local teams so that they can create sufficient value to justify compensation that is substantially higher than the industry average.

Lessons Learned So Far: Embracing Economic Fundamentals & Optimizing for Impact

Bonham Strand is a hybrid turnaround-venture bet based on simple economics that are applicable to any enterprise with the potential to optimize social impact:

1. Sustainable and stable long-term employment must be built on ensuring workers earn income by offering skills-based services that have resilient and meaningful market value;

2. The value created by that labor must be enough to justify incomes well above the federal poverty line to generate significant discretionary free cash flow (in our case, we target purchasing power tax adjusted gross compensation of US\$50,000);
3. Since strip-mining (Amazon) and sharecropping (Walmart) are great for multinationals but bad for local communities, social enterprises should pursue scalable businesses and models designed to keep most net revenues in the community so free cash flow multiplied by money circulation can drive significant local economic impact;
4. If possible, establish multiple entry price points to maximize total addressable market size, secure market differentiation and accelerate engagement (in our case, starting prices of \$75, \$400 and \$800);
5. Definitely embrace technology, sustainable innovation and new value creation methods to achieve competitive advantages;
6. Avoid guilt, charity or "fair trade" premium businesses. They are gimmicky, aren't conducive to building scalable businesses and emit a siren call of enviable but illusory gross margins (e.g., coffee, sandals, costume jewelry);
7. Businesses that can adopt service industry investment, revenue and cost structures allow for a far higher percentage of net revenues for labor-based value creation instead of significant capital investment, real estate, inventory and extended

supply chains;

8. At-risk communities and challenged urban economies represent undervalued distressed asset turnaround opportunities with lower entry barriers, start-up costs and less competition; and
9. America's middle class was built on learning by doing, not university degrees. Our master tailors in Hong Kong didn't need university degrees to achieve 40-year careers and we don't think they are critical for urban economies to recover.

The Big Picture

The fundamentals that are driving Bonham Strand can be readily duplicated and applied to many other industries. We urge current and potential social entrepreneurs to respect the value of their own sweat equity as well as every dollar of financing by wrestling with these issues upfront.

Bonham Strand may have been created in Hong Kong but our objective is to introduce our social impact model to 50 cities in the United States by 2020. Despite making every possible mistake, we have been blessed with modest but venture-scale, year over year growth since our commercial launch in 2012. As I write this article, we are preparing for the official launch of our first two American cities and welcome your friendship, thoughts, suggestions and encouragement.

Author bio

Jong Lee is Founder and Chairman of Bonham Strand, an award winning bespoke apparel social enterprise. He has spent 20 years building and reinventing businesses as a founder, executive, strategist, investor and attorney in the United States, Japan, South Korea and greater China. His current areas of focus include a portfolio of over a dozen early stage technology companies, social enterprises, education initiatives and business turnarounds in Asia, the U.S. and Europe. Jong's strategic advisory clients are primarily multinational corporations and governments.

Jong is co-curator of TEDxHongKong and teaches business reinvention at Hong Kong Polytechnic University and recently led the launch of Unreasonable Labs and Code Club in Hong Kong. Jong is invited to speak around the world on social entrepreneurship, reinvention, innovation and the impact of big data, AI and robotics in the marketplace.

Jong earned his Juris Doctor degree from Columbia University and received degrees in Bioengineering and Political Science from the University of Pennsylvania.

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