



TALE OF THE TAPE

Hil Davis, co-founder of the custom clothing company J.Hilburn, gets sized up by sales reps in training. J.Hilburn's 2,000-plus style consultants, as they are called, record average annual sales of \$20,000—10 times the average for the typical direct-sales company.

Made to Measure

How Hil Davis took a business model people love to hate, filed off the rough edges, took it upscale, and produced a *why- didn't-I-think-of-that* innovation.

Now, who wants to buy a shirt?

BY TOM FOSTER

PHOTOGRAPH BY MICHAEL EDWARDS

The lights dim and the fashion show begins, naturally, with a breathy disco-house remix of a classic funk track. A square-jawed model makes his entrance on the runway in snug khaki pants and an open-collared shirt. He stops to pose halfway down and flash an all-American smile, and the room erupts in cheers and whistles. There are more than 600 women here, about one-fourth of the at-home sales force for the Dallas-based custom men's clothing company J.Hilburn, and they're more than a little excited by what they see.

For the next 15 minutes, models walk the runway in a succession of increasingly tailored looks, moving into sports jackets and suits and eventually outerwear, while the audience mostly behaves itself. Then the runway empties, and there's a pause in the music just long enough to add some drama—until the syncopated bass line of Curtis Mayfield's "Superfly" starts playing, and one of the

models walks out wearing a tuxedo with a green plaid jacket.

Pandemonium ensues. The women are on their feet, cheering, dancing, snapping iPhone photos. Formalwear is the latest addition to the J.Hilburn line, and this is the show's climactic moment, the unveiling of the newest products. I look across the runway at J.Hilburn co-founder Hil Davis; he's beaming like a proud father. The only moment that gets as much cheering is when, after the show, Davis leaps onto the runway and strikes a few exaggerated poses for the crowd.

J.Hilburn is rethinking one of the world's most maligned business models, direct sales (and its pyramid-shaped offspring, multilevel marketing, or MLM). If you're unfamiliar with the term *direct sales*, think Mary Kay or Tupperware—companies whose products are sold in person by off-site representatives working on commission. MLM companies add a twist in that reps are also compensated for the sales of any additional reps they bring on (down lines, they're called), the idea being that each person has an incentive not only to maximize her sales but also to build the biggest possible team. In the U.S., more than 95 percent of direct-sales companies use the MLM model—as does J.Hilburn—and it's not hard to see the appeal. For owners, it means wide-scale distribution and the possibility of viral growth. For sales reps, it means flexible hours and, at least in theory, limitless possible income.

One of the time-honored traditions in the direct-sales industry is that once a year, each tribe gathers its members in a large convention space, and everyone eggs on everyone else. Mary Kay calls it Seminar. Avon calls it Convention. At J.Hilburn, it's known as Conference, and the fashion show is the kickoff event this year, taking place in a giant ballroom with purple carpet in the Cosmopolitan hotel on the Las Vegas Strip. For the next two days, sales reps from around the country (they're called style consultants) will see and hear about new products, get selling tips, hear inspiring stories about fellow reps, and learn about technology tools the company is building as it moves into a new, data-driven phase of its growth—before everyone heads out to catch a show and drink martinis downstairs in the Chandelier bar.

Most start-ups begin with a product idea, and the business model follows—in the case of tech start-ups, sometimes years and millions of users later. J.Hilburn is the opposite.

In a story that's now enshrined in the company mythology,

Hil Davis was reading *The Warren Buffett Way* on a plane about six years ago when he came upon a passage in which the legendary investor said that his best investment ever, dollar for dollar, was not Coca-Cola or American Express or Geico but the direct-sales kitchen-equipment company The Pampered Chef. In fact, Davis learned, Buffett owns several other direct-sales companies, under the umbrella group Scott Fetzer Companies.

"My first thought was, That makes no sense. *Direct sales*? That's a dirty word," Davis remembers. But Buffett was his hero, and Davis found himself preoccupied with figuring out what he had missed about the model. Davis, who talks in a high-speed mashup of business jargon and good-ol'-boy charm, was 33 at the time and working in investment banking as an equity

researcher, a job that paid him the very handsome salary of \$1.4 million. "I loved equity research," he says. "I loved the chess game, the math behind it." Partly, his deciding to examine direct sales in depth was just a way to channel his excess business geekery. It was a puzzle that demanded solving. But he was also restless.

"I was traveling about 150,000 miles a year," he says, "and I thought, Is this really how I want to spend the next 20 years?" He had long thought that he might want to be an entrepreneur one day, and he wondered if Buffett's enthusiasm for direct sales might signal an opportunity. He read a book by the founder of The Pampered Chef, Doris Christopher, and started making a list of the pros and cons of direct sales.

The cons were that direct-sales companies typically end up selling low-end products, which forces the sales reps to chase high volume and be pushy and forces the companies to pay high commissions. "And the culture is just recruit, recruit, recruit," Davis says. Direct-sales companies are notorious for churning through salespeople, who in the worst-case scenario end up with closets full of unsold goods that they had to buy up front.

The most obvious pro was low capital expenditures—you're not building physical stores or restaurants, and you don't have to pay for customer acquisition up front. Less obvious, but intriguing, was direct contact with customers. That could work well in a

luxury-product category that requires high-touch service, Davis reasoned. With a higher price point, he could pay lower commissions and deliver greater value to customers, while his reps could nonetheless make more money.

Davis had covered the retail and restaurant industries as an equity researcher, and that experience led him to two other critical insights. First, he recognized some of the same

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A NEW FANCY

New for the little shirt company that could: formalwear

YOU PAID HOW MUCH FOR THAT SHIRT?

How J.Hilburn can charge \$139 for a custom-made dress shirt cut from the same fabric as a \$395 shirt from a major fashion brand

J.Hilburn makes enough shirts these days that it buys from the same mills, at about the same prices (roughly \$15 a meter for the 120-thread-count Egyptian cotton fabric used in both shirts below), as a major brand like

Ermenegildo Zegna. But J.Hilburn's fabric cost per shirt runs a bit higher, because it's cutting so many specific sizes, which results in more waste. For similar reasons, J.Hilburn also pays more for cutting and sewing. Finally, it

pays more for shipping (because it ships by air, whereas fashion brands, with their long lead times, are able to ship by sea). So the J.Hilburn shirt is a third more expensive to make. How does it end up so much cheaper?

IT ALL ADDS UP

J.HILBURN

Cost of Goods: \$59.20

Direct Commission: \$27.80

Paid to the style consultant who sold the shirt. The percentage is based on how much that salesperson has sold that month, but the average is 20 percent of the cost of the shirt.

Team Commissions: \$15.99

The sales rep who recruited you gets a cut when you make a sale (and so does the rep who recruited her, and so on). On average, the company pays about 11.5 percent on team commissions.

Promotions and Incentives: \$4.87

About 3.5 percent goes to fund sales incentives, such as a program that earns style consultants points toward a new Lexus or Mercedes.

J.Hilburn Gross Profit: \$31.14

The company adds another 22.4 percent.

Total Customer Price: \$139

ERMENEGILDO ZEGNA

Cost of Goods: \$43.35*

Wholesale Markup: \$86.70

In most cases, the wholesale price is 2.5 to 3 times the cost of goods. (We've assumed a 3x markup.)

Retail Markup: \$260.10

Full retail price is usually 2.5 to 3 times the wholesale price. (We've assumed a 3x markup.)

Total Customer Price: \$390.15

(Actual Zegna price: \$395)

*All Zegna costs are estimates.

dynamics in direct sales that he had seen in restaurant chains. This is just franchising on steroids, he thought. What if you could bring to direct sales the things that good franchise businesses do well—build great processes and training and efficient systems and a strong brand identity?

The second insight came from his time covering Amazon, which he had seen cut out steps in the supply chain and squeeze margins in order to sell to consumers with fewer, lower markups along the way. By selling directly to consumers, Davis knew, he could afford to bring his prices way, way down. You don't have to be a business geek to understand that one: Customers would pay less, and a big market awaited.

All right, but a big market for *what*? Davis had devised a

clever business model, and he was eager to get started with it, but he had no idea what industry to apply it in. He started inventorying the rooms in his house—the kitchen, the garage, the bathroom—looking for a product category in need of disruption, until one day his wife, Holly, pointed out that he owned a handful of custom shirts, and they were the only shirts he ever wore. “Why don't you just buy a few more?” she asked him.

“Because they're \$250 a pop, and that's ridiculous,” he said.

“But they're your favorite shirts!” she said. “Why don't you try that business?”

Five years later, J.Hilburn is the single largest seller of men's custom dress shirts in the world. Shirts start at \$89, and they're

made from the same fabric as shirts from the Zagnas and Armanis of the world. Last year, *Esquire* named J.Hilburn the best custom shirtmaker. Since the company officially launched in 2007, it has expanded from dress shirts to custom men's suiting; ready-to-wear casual clothes; belts, ties, cufflinks, and other accessories; outerwear; and now formalwear.

The company brought in about \$35 million in revenue in 2012, up from \$16.7 million a year earlier. The number of sales reps doubled last year, to about 2,250. And those reps' average sales are almost \$20,000 a year, far higher than the direct-sales industry average of \$2,000. The reps' annual retention rate is 87 percent. Things have been good at J.Hilburn over the past year, but it wasn't easy getting here.

One of Davis's first moves was to recruit a co-founder to run the company's operations. Veeral Rathod is a Dallas-native clotheshorse who was also working in investment banking at the time and feeling itchy. Neither man had ever worked in apparel, a notoriously cliquey and idiosyncratic industry, but the two of them figured, How hard could it be?

"We were arrogant at first, and ignorant," Davis says. "In equity research, everything is just numbers. You're asking these questions like, Why aren't you running 15 percent G&A [gen-

eral and administrative costs]? Now I'm like, *Really, jackass? Let me show you.* Because when you actually have to do it and go beyond the numbers, it's so much harder, and it breaks so many different ways, you can't imagine."

Lining up a sales force to launch with was easy enough: They started with one of Holly Davis's friends in Dallas, who went to her friends, and so on. The style consultants would take men's measurements and act as personal shoppers, following up every few months with ideas for a wardrobe refresh. (Holly also gets credit for coming up with the vaguely familiar-sounding, American-heritage-style name, which is short for her husband's full name, John Hilburn Davis IV.)

So far, so good, but problems started piling up quickly. Apparel manufacturers are set up to make products in bulk, and nobody wanted to make one-off custom shirts on a large scale. Through a referral, Davis eventually found a factory in China that said it could do the work. J.Hilburn would be paying more than companies making shirts in just a few sizes, but by cutting out a succession of middlemen, Davis would still be able to sell his shirts at considerably less than the competition would. (See "You Paid How Much for That Shirt?," page 67.) It seemed like a solid win, but by then a second problem had

NOT YOUR MOTHER'S MLM

Avon. Mary Kay. Tupperware. Very large companies have been built around multilevel marketing, thanks to its ability to achieve massive scale quickly and cheaply. But MLM is also notorious for underdelivering on product quality and price and churning through salespeople. A few key tweaks to the model allow J.Hilburn to avoid those pitfalls.



Limit recruiting

In most MLM companies, the emphasis for salespeople is on recruiting as many other reps as possible to earn commissions from their sales. At J.Hilburn, reps can recruit only five people. If they hit sales targets with that small team, they unlock the ability to recruit more people. The result is an emphasis on building the most productive team possible rather than the largest.

Eliminate market saturation

Another common problem with the traditional MLM model is that, in a rush to recruit large down lines, reps end up cannibalizing their own sales, because naturally they recruit people in their own social networks and geographic areas. J.Hilburn combats this problem by setting a cap on the number of reps in any given market, based on the size and maturity of the market.

Don't make reps pay up front

Studies show that more than 99 percent of MLM reps end up losing money (hence the common comparison to illegal pyramid schemes), and the biggest reason is that many companies force reps to buy products up front at wholesale prices. Because J.Hilburn makes its products on demand, customers buy directly from the company, and reps act more like traditional salespeople.

Control the customer experience

The company keeps an invisible hand in sales wherever possible. Slick look-books reinforce the luxury branding. A new iPad app for salespeople feeds them smart recommendations and flags potential measurement errors. And targeted e-mail marketing and e-commerce can take the salespeople out of the reorder process entirely (while still paying them commissions).

arisen: The best fabrics come from a handful of mills in Italy, and without any industry credibility, Davis couldn't get any of them to return his calls. Again, Asia came to the rescue, and the company launched with a selection of 20 fabrics from a mill in China.

On the day the first shipment of shirts arrived in Dallas, Davis and Rathod swaggered into a restaurant where a few of the company's initial salespeople were eating. "We were so proud," Davis remembers. "And then we washed the shirts a couple of times," says Rathod. The fabric immediately lost its hand, its feel. It turned out the Chinese mill used lower-quality fabric and perhaps treated it with a chemical spray that gave only the impression of higher quality, and only at first.

The stress of this difficult start began to take a toll on Davis. One night in October or November 2007, he had drunk some wine, it was 2 a.m., and he decided to call a premier Italian mill, Tessitura Monti. "I said, 'I'm about to drop a million dollars on fabric, and since I know you're not going to return my call again, I'm going to take my business to this other Italian mill.'" It was a pure bluff—he didn't have a million dollars to spend—but he got a call back within minutes and managed to talk his way into a much smaller, more realistic deal.

Still, bigger problems remained. When the first customers started receiving shirts, many didn't fit properly. It turned out that the reps were measuring a customer's neck, chest, waist, and arms, but the factory was custom making only the collar. Davis and Rathod hadn't adequately vetted their supplier.

Things got even worse in late 2007, when the company switched to a different factory and product turnaround time went from the promised four to six weeks to eight to 12 weeks or even longer. And shirts were showing up 3 inches too short and had to be sent back and redone. "We had a five-minute conversation and decided to say to customers, 'If a properly fitting shirt doesn't land in four weeks, you get a free shirt,'" Davis says. "It ended up costing me \$75,000."

Davis and Rathod decided to move back to the original factory and iron out the problems, but by the time they had worked through the backlog of orders, it was September 2008, a year and a half into the life of the company. Davis estimates he lost 50 percent of his early customers as a result of all the production issues. Except for a friends-and-family round of financing, he had funded the company's launch on his own. He had not paid himself any salary, and he had \$100,000 in credit card debt. The bank foreclosed on his house, and he moved his family—he now had twins—into an apartment.



SELL IT!

J.Hilburn reps. in Las Vegas for the company's most recent convention-cum-pep rally, examine the new line. Nearly all J.Hilburn reps are women.

Davis got an offer to return to Wall Street: three years, \$3 million. He swallowed hard and turned it down.

"I remember sitting up one night thinking, What have I done? Was I so arrogant that I didn't get it? Did I miss something in the model? It's an incredibly humbling experience. I couldn't talk to anybody. Holly was like, 'You have these girls now, and you're not spending any time with them!' But it's so hard to look someone in the eye and know that you're fundamentally failing them. I was used to being a provider, and now I couldn't write a goddamn grocery check."

It was around this time that Davis got an offer to return to Wall Street for what's called a 3-by-3 contract—three years,

\$3 million. "I knew that every year I stayed out of equity research, I became less valuable," he says. "So if I passed up this job opportunity, it might never happen again."

But he swallowed hard and turned it down. A couple of months later, J.Hilburn closed its first round of venture capital financing, with a million-dollar investment led by the firm Battery Ventures.

"Wooooooo! Wooooooo!" The style consultants are screaming again. It's the morning after the fashion show, and the Cosmopolitan's ballroom has been transformed into a cavernous auditorium with a stage flanked by giant video screens that beam the onstage action all the way to the back rows.

So far, much of what I have seen of Conference has felt as much like a motivational self-help seminar as it has a professional convention. There was the Million Dollar Achievers session, in which a few longtime sales reps who have made hundreds of thousands of dollars told stories of their personal struggles and triumphs and exhorted the audience to "believe." There were a few early-morning sessions about menswear

trends (pants: brighter and tighter) and selling tactics.

And now things take a different turn as Rathod bounds out to center stage to heavy applause and introduces the company's new iPad app, the J.Hilburn Style Kit, which is available only to style consultants as a sales tool and includes a full catalog, a mix-and-match function for building outfits and whole wardrobes, and real-time inventory information, so they don't make a sale on a ready-to-wear item that's out of stock. For every past customer, it also includes a purchase history and measurements. Watching the demo, the reps in the audience *ooh* and *aah* about how much easier their jobs promise to get (no more paperwork! no more inventory snafus!), but that's only part of the appeal to Davis and Rathod. The app represents one of the company's first big steps toward realizing an ambitious data-driven strategy for the future.

"Just think about all the data we have," Davis says to me that evening. "We know fit preference, we know measurements, color preference, where you live. And now think of all the ways we'll be able to mine that data. Nobody has all this. Nobody." He's right. Amazon, Zappos, J.Crew, Nordstrom...it's hard to think of a company that has the level of detail about its apparel customers that J.Hilburn does, especially when it comes to measurements, because the company is not just logging whether someone's a size Large but actually recording precisely how large, in all the key places.

How does that matter? To put it in Davis-style terms, J.Hilburn will be able to scale personalization. That means e-mail updates with smart product recommendations—simple things like matching ties for your shirts, but also more sophisticated picks based on unexpected correlations. For instance, if most people in Minneapolis who buy V-neck sweaters and striped shirts also buy sports coats, anyone there who bought a V-neck sweater and a striped shirt but hasn't yet bought a sports coat should get an e-mail that recommends a specific sports coat, made to his precise measurements—and he can simply click to buy.

The opportunity lies not just in e-mails, of course. Via the app, J.Hilburn will be able to keep an invisible hand in the in-person interaction between client and salesperson, to help push up order size. On the website, what each customer sees will be unique to his history, much as on Amazon or Netflix but based on data that's quite a bit more personal. And because J.Hilburn gives sales reps the same commission for online transactions as it does for in-person ones (even if the rep had no part in the sale), there's no risk of eroding commissions and driving the sales force away. In fact, J.Hilburn wants to drive reorders to its digital channel, because it means the reps have more time to scout for new customers.

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The products themselves are getting a data-driven makeover, too: "The next evolution is, we could have a dozen variations of the size Small for our ready-to-wear collection," Davis says. "We can take our customer buckets and really narrow them down, to get as close as possible to a perfect fit off the rack. Retailers and brands are never going to do that, because they're not going to take the inventory risk without having the data to support it. We already have the data."

The counterpoint to all the new digital focus is the style consultants. They're the company's human face and the equivalent of 2,000-plus storefronts (and growing). "Nordstrom can never open a store in Tulsa," Davis says, "but we have five style consultants there. We crush it in Tulsa. We crush it in Baton Rouge. And it's not like we need a million dollars from each of them to justify doing business there. We need \$2,000—and, in fact, we get \$20,000."

Of course, the in-person social element can work against the company, too. When you're adding thousands of salespeople, you're bound to land some duds. I saw this firsthand a month before Conference, when I attended a J.Hilburn training session in Manhattan. Of the four young women there to learn the ropes, only one had any real experience measuring customers, and two seemed less than confident at making sales calls. There were a lot of fumbled lines and poorly measured sleeves in the practice sessions, and I kept finding myself thinking, What happens when a customer has this as his first experience with J.Hilburn? It's not going to inspire trust, and if the clothes come back ill fitting, there's a good chance

he's been lost forever. Worse, with social media, the word of bad customer experiences can spread quickly.

Davis and Rathod aren't blind to those risks, and they're investing heavily in training and sales tools. Conference and the iPad app are prime examples, and so is an elaborate continuing-education program. On a tougher note, the company is working to establish a rating system for sales reps, whereby those who get low scores make smaller commissions and presumably move on quickly. Meanwhile, Davis is back at his spreadsheets and planning for fast growth. At current growth rates, he projects the company will have around 50,000 reps worldwide in five years (not a crazy number, given that direct-sales stalwart Mary Kay has more than two million). If per-person earnings stay around \$20,000, that would make J.Hilburn a billion-dollar business.

But that's all numbers and theory. As Davis will be the first to say, actually getting there is the hard part. **1**

Tom Foster wrote the February 2012 cover story on the camera maker GoPro.