

RMG exports to double by 2015, triple in 10 years: McKinsey

Bangladesh may reach growth targets if it overcomes challenges to the industry: report



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The story of Bangladesh has just begun. With garment buyers moving out of China, the sourcing caravan is moving on to the next hotspot: Bangladesh. McKinsey & Company, a trusted consultant for many of the world's influential businesses and institutions, has done a case study that reviews Bangladesh's garment growth formula. It predicts that the country's apparel exports will double by 2015 and nearly triple in 10 years. The future growth of RMG exports will require an additional 3.5 million workers by 2020. The report, prepared in collaboration with the Bangladesh German Chamber of Commerce and Industry and made available exclusively to The Daily Star, explores what it takes to be the next big destination for global buyers. The report also flags some challenges to the apparel industry. Bangladesh may miss the opportu-

The sourcing of RMG is experiencing a new phase of transition, which is creating the need for companies to react accordingly in order to secure their cost positions in the apparel market

Foreword

A growing number of chief purchasing officers (CPOs) in European and US apparel companies are scrutinising their sourcing strategies, as margin and supplier capacity pressure building over the last several years has caused them to search for the next performance improvement opportunity.

While China is starting to lose its attractiveness in this realm, the sourcing caravan is moving on to the next hot spot. With Bangladesh having developed a strong position among European and US buyers, many companies are already eager to evaluate the future potential. However, the lure of competitive prices, available capacities, and supplier capabilities offered is being cautiously weighed against a prevailing insecurity created by the challenges inherent in Bangladesh's readymade garments (RMG) market.

McKinsey & Company has initiated a case study that sets out to review Bangladesh's RMG growth formula, which builds on the country's strong starting position and the increasing demand of international buyers. This report provides an overview of the rapid growth being seen in Bangladesh's RMG industry and then describes the main hurdles that exist for buyers when it comes to sourcing in Bangladesh. The final section of the report details what the three core stakeholders -- government, suppliers, and buyers -- can do to overcome the challenges of growth in Bangladesh's sourcing market.

The case study and recommendations documented in this report are based on:

- An extensive interview-based survey of CPOs from leading apparel players in Europe and the

US, accounting for \$46 billion in total apparel sourcing value and covering 66 percent of all apparel exports from Bangladesh to Europe and the US.

- A telephone survey of 100+ local RMG suppliers in Bangladesh, which represents approximately 10 percent of Bangladesh's total apparel exports.

- In-depth desk research using both international (World Bank, International Monetary Fund, EIU, investment banks) and local sources (Bangladesh Garment Manufacturers and Exporters Association, Centre for Policy Dialogue, Bangladesh Institute of Development Studies).

- Extensive field work, including in-depth supplier interviews, factory visits, interviews with sourcing office managers, and discussions with other local and international experts (corporate social responsibility experts and logistics experts).

McKinsey wishes to thank all participants of this study, especially the Bangladesh German Chamber of Commerce and Industry (BGCCI) President Md Saiful Islam and Executive Director Daniel Seidl, for their support in compiling this report.

Potential for rapid growth of Bangladesh's RMG industry

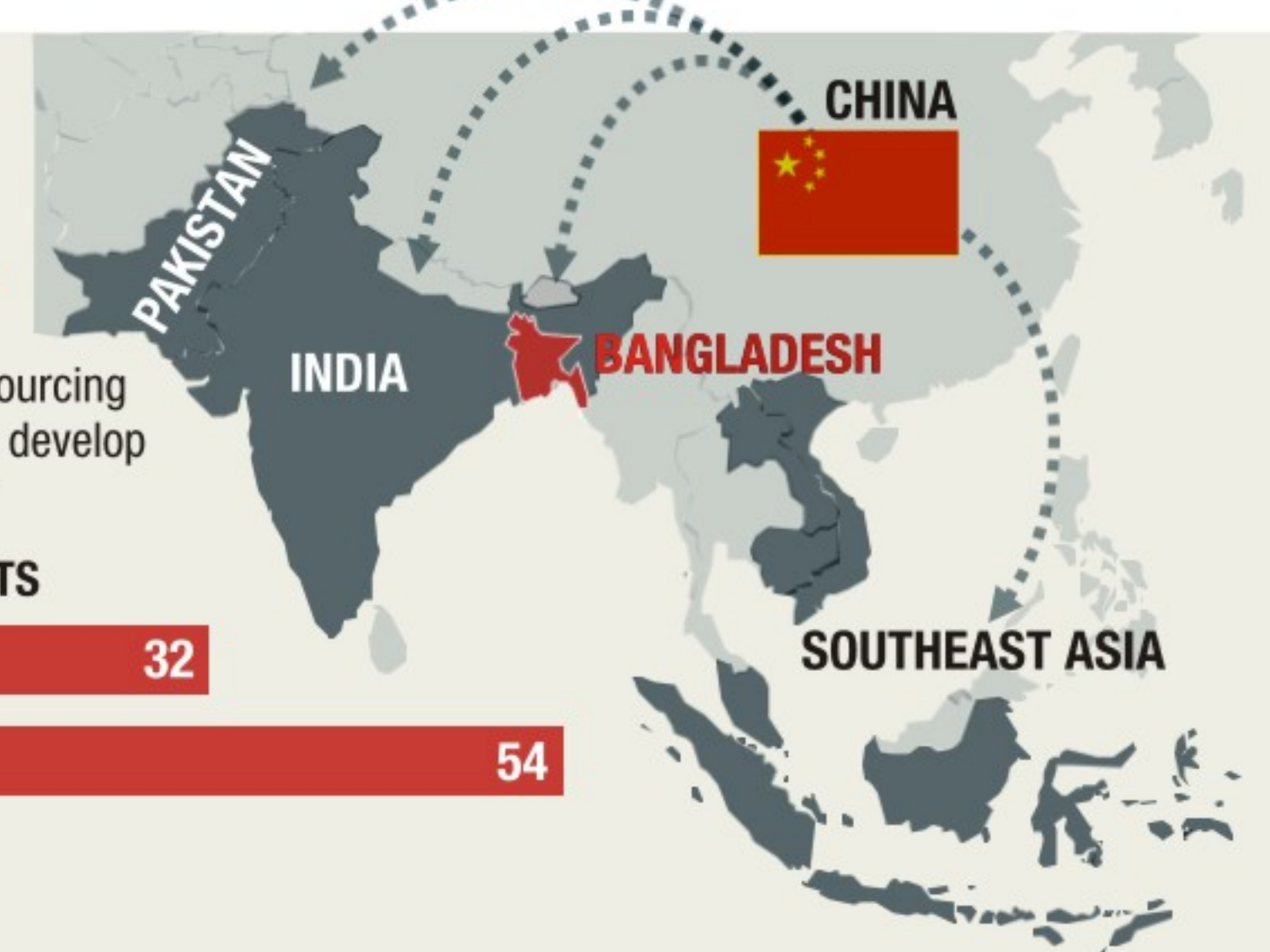
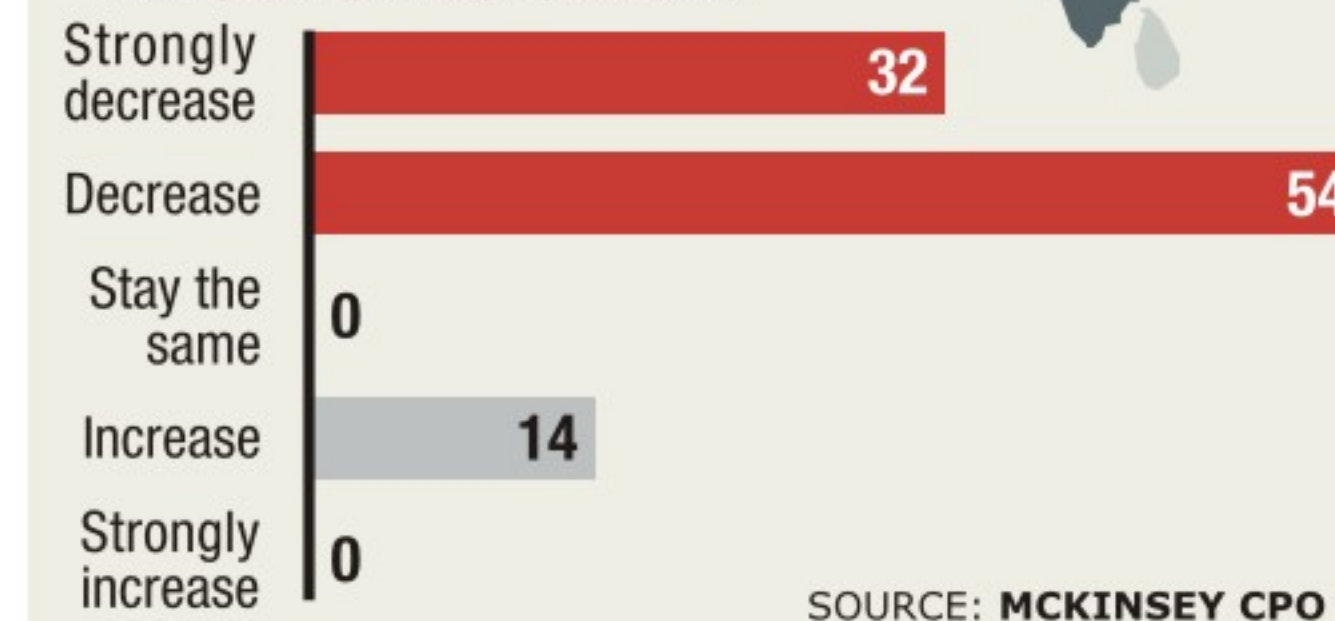
The sourcing of RMG is experiencing a new phase of transition, which is creating the need for companies to react accordingly in order to secure their cost positions in the apparel market. While China was once considered "the place to be" for sourcing, the light is starting to shine ever brighter on Bangladesh.

Exhibit 1

CPOs plan to shift a large share of their sourcing value away from China to other countries over the next 5 years

"How do you expect your sourcing share (value) from China to develop during the next 5 years?"

PERCENT OF RESPONDENTS



SOURCE: MCKINSEY CPO SURVEY, SEPTEMBER - NOVEMBER 2011

Current trends on the buying side

For decades, European and US apparel buyers were benefiting from continually decreasing purchasing prices by moving their sourcing activities to low-cost countries in the Far East and by cutting out the "middle man." Sourcing teams could freely take their pick of the next country sourcing opportunity along the five main criteria of price, quality, capacity, speed, and risk.

Within the last several years, however, European and US buyers have been faced with a growing number of margin and capacity issues, creating an increase in sourcing strategy revisions.

Although the European and US apparel markets have regained much of their sales following the slump brought on by the most recent global financial downturn, market saturation, consumer price sensitivity, and ongoing economic insecurity continue to put pressure on top-line results.

In addition, the end of a 15-year long apparel sourcing deflation is squeezing the profitability of buyers. Volatility of raw materials prices has spurred a decline in gross margins and created a general environment of insecurity among buyers. At the same time, labour costs in China and other key sourcing markets have increased significantly. This is leading buyers to question their current sourcing strategies, resulting in expansion of global direct sourcing and footprint revisions being the current key strategic focus areas.

However, the playing field is becoming increasingly limited for European and US buyers, as new, fast-growing markets develop into important customers for the traditional sourcing markets. These countries' high growth levels and, to some extent, proximity to the markets, make them attractive. A battle for capacities is on the horizon.

For many years, China was almost always the hands-down answer to all buyers' needs, but those times are changing.

China is losing its attractiveness for new and established buyers

In 2010, China dominated RMG imports to Europe and the US, accounting for approximately 40 percent of the import volume in each region. The macro-trends of wage increases and capacity pressure, however, have proven to heavily weigh on the Chinese RMG sector. McKinsey's survey shows that CPOs of leading apparel buyers in Europe and the US almost unanimously favour moving some of their sourcing away from China. In the survey, 54 percent of CPOs shared their plans to decrease their sourcing activities in China by up to 10 percent and 32 percent stated that they sought to decrease their share of sourcing in China by more than 10 percent over the next five years (Exhibit 1).

- Labour shortages, especially in the coastal regions, are impacting the RMG industry in China, as workers continue moving on to more attractive industries and better jobs.

- Wages in Coastal China are increasing, as Chinese RMG manufacturers try to better position themselves in the tight labour supply market.

- Capacity for Western buyers is reaching its limits, as RMG players in Coastal China switch to serving the quickly growing, more profitable national market and as the Chinese government seeks to support more value-added industries in an effort to rebalance the economy. Since 2000, the share of total apparel exports has been reduced to nearly half of historical levels.

As Western RMG buyers search for the "next China," they are evaluating all options to strengthen their proximity sourcing, moving on to Northwest China, Southeast Asia, and other Far East supplier countries.



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Dr Thomas Tochtermann, director of McKinsey & Company; Dr Achim Berg, principal of McKinsey & Company; Faruk Khan, third from right, former commerce minister and current civil aviation and tourism minister; Md Saiful Islam, extreme left, president of Bangladesh German Chamber of Commerce and Industry (BGCCI); and Daniel Seidl, executive director of BGCCI, pose for photographs at an event in Dusseldorf, Germany, in September. The findings of the McKinsey report were presented there in front of 15 CEOs of top brands.