Bangladesh: next sourcing hotspot in 5 years

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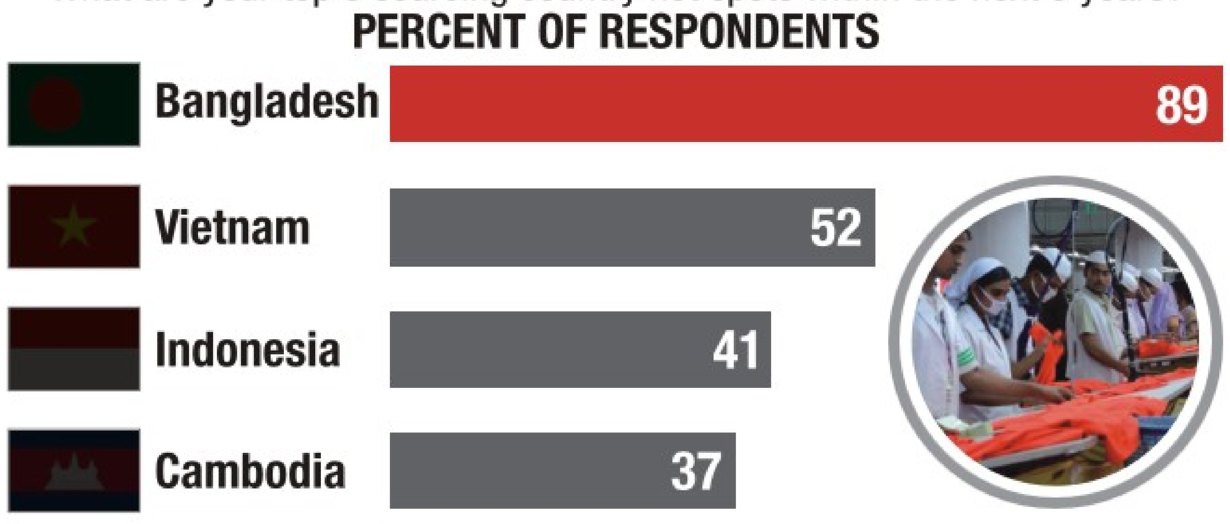
A state-of-the-art cutting machine is pictured at a garment factory in Gazipur, a hub of apparel manufacturing. Bangladesh attracts global buyers more than before, as they are moving out of China.

Bangladesh offers the two main "hard" advantages -- price and capacity. It provides satisfactory quality levels, especially in value and entry-level mid-market products, while acceptable speed and risk levels can be achieved through careful management

Exhibit 2 FOR MOST CPOS, BANGLADESH WILL BE THE NO. 1 SOURCING HOT SPOT OVER THE NEXT 5 YEARS

"What are your top 3 sourcing country hot spots within the next 5 years?"

PERCENT OF RESPONDENTS



SOURCE: **MCKINSEY CPO SURVEY, SEPTEMBER - NOVEMBER 2011**

FROM B3

Bangladesh is clearly the preferred next stop for the sourcing caravan (Exhibit 2).

Bangladesh has what it takes to be the next sourcing hot spot

Since the start of its garment export industry in the late 1970s, Bangladesh has seen its RMG export levels grow steadily and has become a top global exporter. With around $15 billion in export value in calendar year 2010, the RMG industry is currently Bangladesh's most important industry sector (13 percent share of GDP and total export share of over 75 percent). With 12 percent average annual growth rates, clothing exports are the key driving force behind GDP development (7 percent CAGR from 1995 to 2010). The attractiveness for buyers lies in Bangladesh's long-term experience and strong performance in the sourcing country selection criteria of price and capacity as well as product portfolio offered.

Leading international retailers, especially from the value sector, started to source in Bangladesh already in the 1980s. Over time, buyers have strengthened their sourcing base by shifting toward direct sourcing and opening their own local offices in Dhaka and Chittagong. Of the European and US buyers McKinsey surveyed, 72 percent of those with activities in Bangladesh source directly. The high share is confirmed by the suppliers -- 69 percent of the surveyed suppliers focus on working directly with international buyers.

In the last 15 years, Bangladesh's share of apparel imports to Europe and the US more than doubled, securing Bangladesh's No. 3 position among importers to the European Union 15 (EU-15) and the No. 4 position among US importers. Within just the last three years, 39 percent of the companies represented in the CPO interviews have increased their share of sourcing in Bangladesh by more than 30 percent, 13 percent of the companies by 20 to 30 percent, and 30 percent of the companies by 10 to 20 percent.

Bangladesh's growth has been recognised. Goldman Sachs included Bangladesh in the "Next 11" emerging countries to watch following BRIC (Brazil, Russia, India, and China) and JP Morgan lists Bangladesh among its "Frontier Five" emerging economies in which it is worth investing.

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Competitive price level is clearly the prime advantage -- all CPOs participating in the study named price attractiveness as the first and foremost reason for purchasing in Bangladesh. Within the next three years, both CPOs and suppliers expect a labour cost increase of about 30 percent. Not only are all stakeholders certain about increases in the future, they see it as a necessity, since minimum wages had not been adapted for a long time despite high inflation. It wasn't until November 2010 that wages were raised for the first time since 2006. And it has been announced that minimum wages will be adapted regularly in two-year rhythms. Leading suppliers already offer annual wage progression as well as profit contributions.

Respondents see the development of wages in Bangladesh being in line with that in other countries. And as they expect significant efficiency increases to offset rising costs in the future, respondents state that Bangladesh's price levels will remain highly competitive in the future.

Half of the international CPOs interviewed mentioned capacity as the second-biggest advantage of Bangladesh's RMG industry. With a current 5,000 RMG factories employing about 3.6 million workers from a total workforce of 74 million, Bangladesh is clearly ahead of Southeast Asian RMG suppliers in terms of capacity offered (e.g., Indonesia has about 2,450 factories, Vietnam 2,000, and Cambodia 260 factories). Other markets, such as India and Pakistan, would have the potential to be high-volume supply markets, but high risk or structural workforce factors prevent utilisation of their capacity.

Supplier capability ranks third mentioned by 30 percent of respondents in the survey of European and US CPOs. However, the current acknowledgment of capability is very focused: Bangladesh's suppliers are known for supplying good quality and large order sizes for the value and lower mid-market. At the same time, suppliers have started to expand into more value-added services (Exhibit 3).

In addition to price, capacity, and capability, a high share of European CPOs strongly emphasise the advantages of sourcing in Bangladesh due to favourable trade agreements. The broadening of the EU Generalised System of Preferences (EU-GSP) rules on duty-free imports of garments from Bangladesh to include products with twostage processing made sourcing from Bangladesh even more attractive. A shift from the currently dominant knitwear (70 percent of import value to the EU-15) to a more balanced sourcing product portfolio can be expected (e.g., the US sourced 26 percent knitwear and 74 percent wovens in 2010).

This advantageous starting position in terms of price, capacity, capability, and trade regulations provides the base for positive RMG growth in Bangladesh. And the strong demand of international buyers from Europe, the US, and emerging markets will accelerate it in the future.

In the medium term, Bangladesh looks to be the sourcing country of choice

For the next ten years, McKinsey forecasts a continuation in the high growth of Bangladesh's RMG sector. Driven by the sourcing trends described previously and Bangladesh's current starting position, European and US buyers will continue expanding their sourcing activities in Bangladesh. Additionally, new buying markets are becoming increasingly important as sourcing customers for Bangladesh (Exhibit 4).

European and US CPOs aim to significantly grow their share of sourcing in Bangladesh. Companies focused on a value segment plan expansion from a current average 20 percent to a 25 to 30 percent sourcing share in 2020. Mid-market brands, which generate around 13 percent of their sourcing value in Bangladesh today, plan to grow their share to 20 to 25 percent in the medium term. This growth will be driven not only by an increase of volumes in current product categories but, as stated by 63 percent of CPOs interviewed, by broadening the sourcing strategy to more complex, more fashionable, or more sophisticated items (e.g., the most frequently mentioned categories are outerwear and formal wear for value markets, and an expansion of existing products as well as flat knits for mid-market players). This means that the value market will be the key volume contributor, while the mid-market will demonstrate more dynamic growth (i.e., higher CAGR). Also, many Western mid- to upmarket buyers have recently begun or have concrete plans to source from Bangladesh.

Interesting to note is that a new class of attractive customers for Bangladesh's RMG industry is growing quickly.

Garment exports from Bangladesh to new buying markets --those seeking alternative options in supplying products to their fast-growing consumption-oriented middle class -- showed a CAGR of 56 percent in the period 2008 to 2010. Especially regional countries want to benefit from the advantages Bangladesh has to offer. Not surprisingly, suppliers in Bangladesh see China as the country gaining most importance for them over the next ten years, with India following suit with a ranking of third. Bilateral agreements, such as the recent duty-free deal between India and Bangladesh announced in September 2011, are being established in order to foster increased trade.

Taking these drivers into account, Bangladesh's RMG industry will continue to face growing demand. McKinsey has forecast demand growth through 2020, based on its CPO survey, which covers approximately 66 percent of Bangladesh's total export value to the US and Europe. CPOs of value players want to increase the value of their sourcing in Bangladesh by about a 10 percent annual growth rate, whereas mid-market players plan an annual growth rate of around 14 percent.

Looking at the demand side from existing and new markets, an annual value increase of Bangladesh's RMG industry of around 13 percent is likely. The supplier survey paints a similar picture, with some 73 percent of suppliers believing in strong growth of more than 10 percent per annum within the next ten years.

However, a number of significant challenges brought on by growth exist. Depending on how well the most severe issues can be managed, the market will realistically develop at an annual rate of 7 to 9 percent within the next ten years, resulting in an export value of around $36 billion to $42 billion. This means the market will double by 2015 and nearly triple by 2020.

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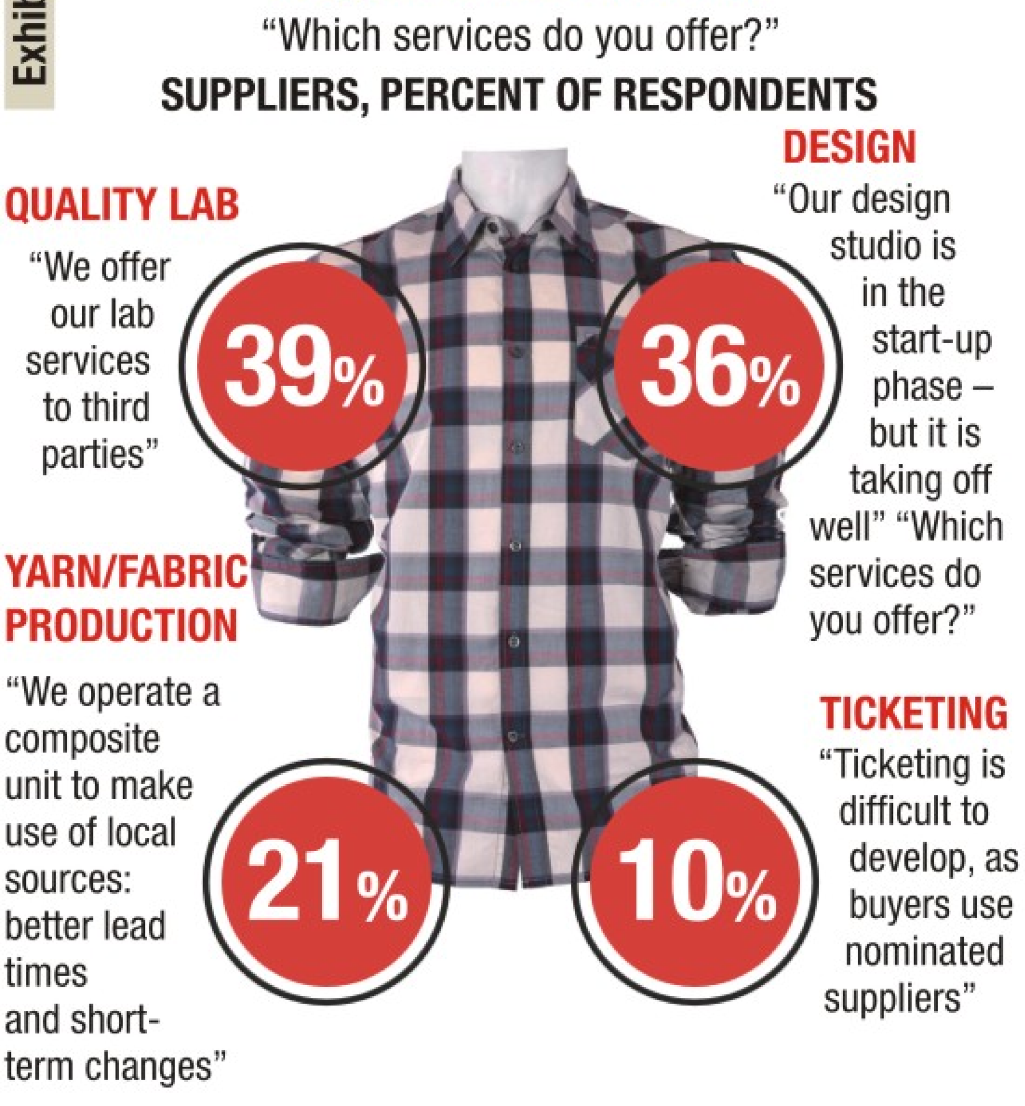
Exhibit 3 Suppliers are starting to move beyond pure CMT and to upgrade their service levels

"Which services do you offer?"

SUPPLIERS, PERCENT OF RESPONDENTS

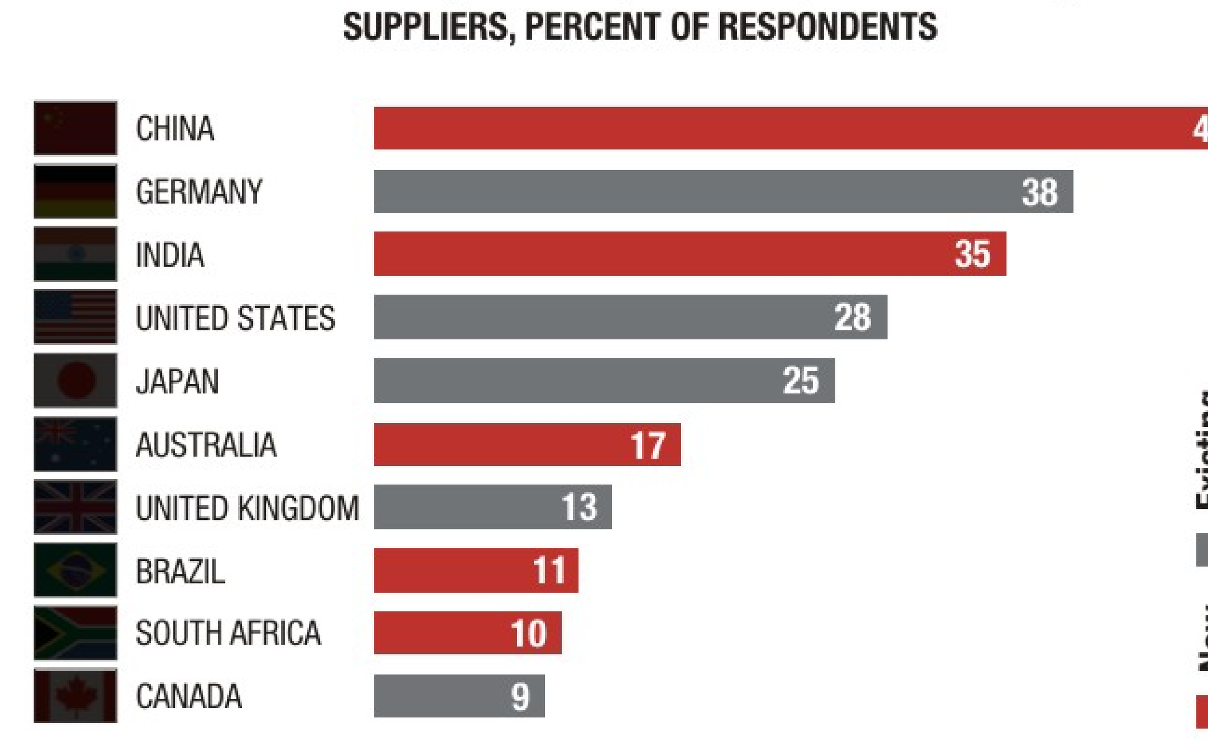


SOURCE: **MCKINSEY SUPPLIER SURVEY, SEPTEMBER 2011**

Exhibit 4 Increased demand is expected from new buying markets in the region and international emerging markets

"Which 3 countries will gain most importance for you in the next 10 years?"

SUPPLIERS, PERCENT OF RESPONDENTS



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