

Global sourcing after 2005

It's a simple question. Shall we see a new world order following the elimination of quotas and tariffs on December 31, 2004? And there's a simple answer – or at least there appears to be if you were privileged to listen to a presentation given by Hendrik van Helden to an invited audience in Monte Carlo last autumn.

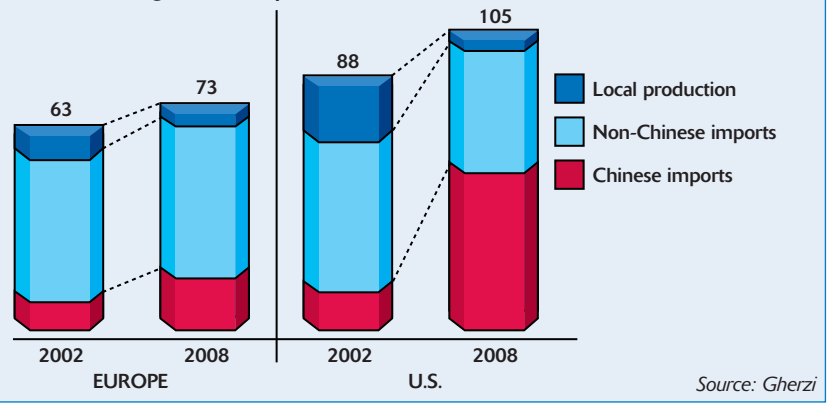
Hendrik's textile consultancy and engineering group, Gherzi van Delden GmbH, deploys 300 people in Europe and Asia to work with leading companies in the chemical, fibre, fabric and apparel industries on issues of global strategy and operational improvement. Increasingly it is being asked for solutions to the problems inherent in the globalisation of the textile industry post-January 2005.

What follows is the essence of Hendrik's words encapsulating the opportunities and the potential in the situation.

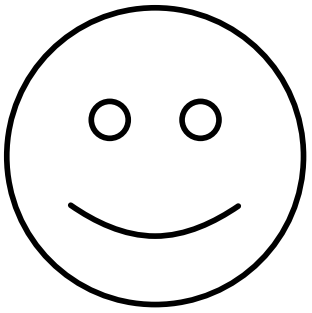
There is no doubt about the accuracy of the statement that the WTO's Agreement on Textiles and Clothing (ATC) is going to affect everybody from manufacturers through brand-owners to the end-users. At the moment the potential in Chinese production is seen as a major threat to the rest of the world. But we should like to suggest that the globalisation of the textile trade present new opportunities to those who are willing to indulge in a little lateral thinking.

Let us take a look at the current situation. The ACT foresees a gradual elimination of textile duties and quotas among member states through to December 31, 2004. To react to disruptive influences such as an excessive growth in imports to any one area, e.g. from China, a safeguard clause exists to permit a level of market protection; this clause remains available to all WTO member states until 2008. There can be no doubt in anyone's

Growth of Chinese garment imports.



Source: Gherzi



China

mind that China will be the key competitor in this scenario, with a projected growth factor of 2.75% between 1990 (8% of the world trade in textiles and garments) and 2006 (22%).

The market penetration of Chinese-produced apparel will increase until 2008 both in Europe (+8bn Euros) and the US (+40bn Euros). Local production – most notably in the USA – will be affected. The Gherzi prediction is that duties and quotas will fall by the end of 2004, both in the US and Europe, but with the following effects:

- lower retail prices for US consumers and export opportunities (to China) for high technology companies operating in the aviation, telecommunications and computer sectors. These carry more economic weight with the US government than the potential loss in textile trades employment in Southern USA and Mexico. (Gherzi view)

- the European Union has already taken the decision to open up its markets by 2005 on the premise that'...the negative impact of the elimination of quotas will be less than expected due to the high share of technical textiles and high value-added products in the portfolio of most European producers.' (EU statement on a study carried out jointly with Euratex.)

New opportunities

"If you can't beat them, join them. It is a fact that many opportunities exist for involvement in low-cost production in China – and also in the importation of the textile products so produced. The relevant cost factors may be a surprise to many, but the essence is that they can be made to work for you – and not against you.

Of course some will say that the relevant textile technology is not available in-country, but in many key raw materials China is already a major producer, e.g. 14% of the world's PA6 nylon filament, 25% of the cotton yarns and 41% of the total PES filament. By 2008 we suggest that you should add the production of significant amounts of PA66 micro fibres, elastane and viscose into the calculations.

There is always a degree of volatility in textile and clothing manufacturing, and for certain we shall be viewing a major shake-up in market shares and competitive activity in 2005. This represents an opportunity for acquisition and adjustments in market positioning; to some degree this is already happening, for example the latest activities of Berkshire Holdings in the USA and those of the Daun Group from Germany and the Bonazzi and Radici groups in Italy are the direct results of similar market adjustments.

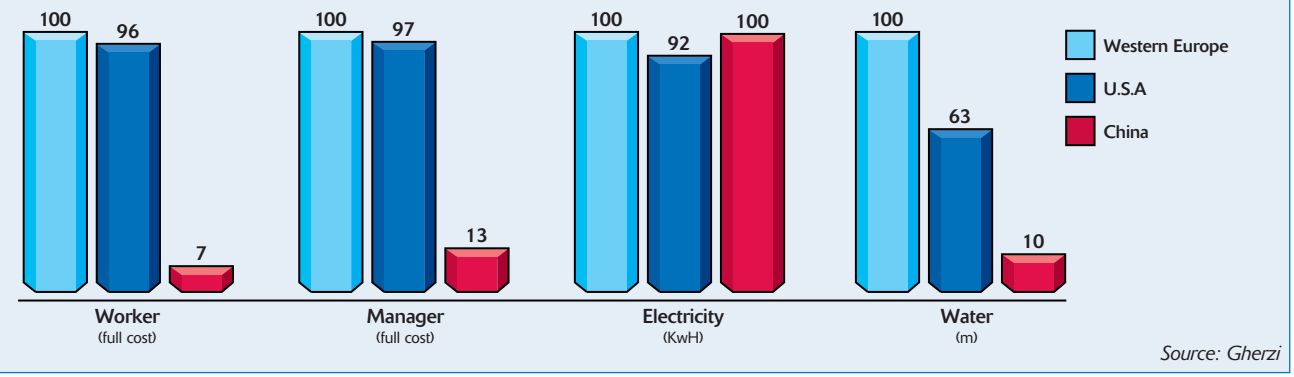
Our estimates show that by 2008 there will be 150 million new middle and upper class customers split between Eastern Europe and China – and all asking for upmarket textiles and garments carrying internationally desirable brands. The 'split' will be approximately 70 million in Eastern Europe and 80 million in China, but by anyone's standards they are markets worth capturing and cultivating.

How to react

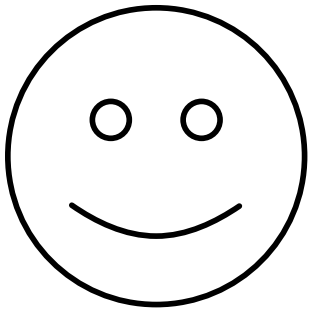
The key issue in making the most of those opportunities is the ability to defend the home base. To do so manufacturers should concentrate on differentiation, time-based competition and branding – and use them as both weapons and ploughshares to achieve a price premium against Chinese imports and build a value-added base in China itself.

Consider the relevant manufacturing costs of a pair of women's trousers made up in China and Romania respectively. Delivered to the EU, and without duty, the Chinese product will average 10.27 Euros. Using an Italian fabric, the textile input Romanian costs are 75% higher, but significantly lower freight charges bring down the final difference to just 2.43

Low factor costs in China.



Source: Gherzi



Rest of World

Euros or 23.6%. Additionally the Chinese manufacturer will demand a take-up of something in the order of 30,000 pieces in each colour, against less than 3,000 pieces from Romania. And if the Eastern European products happen to carry a desirable brand…

- Differentiation – the Chinese manufacturing strengths lie in three areas. Low costs where local supplies of raw materials exist; modern equipment; mass production. The weaknesses include the lack of a culture geared to producing small lots and custom-made products; a difficult and remote legal system; all specialty raw materials need to be imported.
  By contrast European and American opportunities include the ability to produce high value-added products with a compatible quality risk factor; the ability to produce custom-made goods in small lots using efficient and flexible machinery; the ready availability of specialty and high performance raw materials.

- Time-based competition – there is an approximate average labour cost differential of 23% between garments produced in China and Romania, but the time to market – say in the Benelux countries – carries a penalty of over four weeks for the Chinese goods. (The alternative of air freight incurs a cost penalty of one extra Euro per kilogramme.)

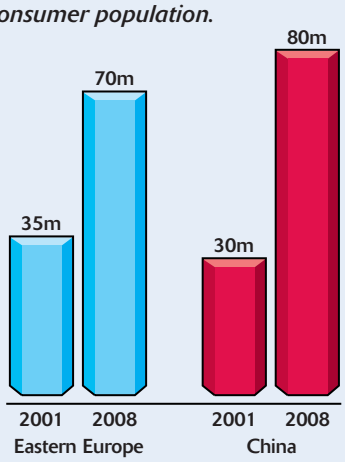
- Branding – in simple terms I can give you three highly successful examples of price premium branding, some of which are now being produced under Chinese manufacture in order to provide closer links with the Eastern hemisphere.

Our first has to be Invista/DuPont with its stable of brands such as Kevlar, Tyvek, Lycra, Tactel, etc., versus any number of no-name products. Second, one should consider W L Gore's Gore-Tex product range – which has a number of premium branded competitors such as Sympatex and eVent, and a myriad of no-name membranes looking for a 'me too' label. Finally, Malden Mills – much troubled of late, but nevertheless showing signs of good heart – with its highly respected Polartec fleece range which is also a useful example of value-added marketing.

Be prepared to take profit from new opportunities. The growth of technical textiles in emerging markets in Eastern Europe and China offers many interesting options in the automotive, medical and hygiene sectors. The ability to reorganise sourcing to become more cost competitive has additional benefits when the cost improvements are passed through the chain, another important factor being that origin also loses its importance when quality is maintained.

New alliances can be encouraged by linking with complementary local production facilities. In doing this participants gain from the benefits of scale and can attack global opportunities together. Encourage an opportunistic view of Chinese and Eastern European joint ventures, and particularly so where they can help to penetrate new markets and improve your own cost position.

Growth of middle and upper class consumer population.



Source: Gherzi

In summary

- Protect the home base.
- Profit from new opportunities.
- Be prepared to seek out and accept new alliances.

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