

# [The apparel industry in sri lanka economics essay](https://assignbuster.com/the-apparel-industry-in-sri-lanka-economics-essay/)

The apparel industry in Sri Lanka rapidly developed in the mid 80’s after the implementation of the open economic policy. Industrialization was given first preference in order to move the economic structure from an agricultural base to an industrialized and service oriented structure by the government. As a result of this policy the apparel industry was given special preference and steps were taken to promote this industry amongst local and foreign industrialists.

The commencement of industrial development zones and export zones directly benefited investors and enabled them to easily set up their infrastructure needs. Apart from this, certain trade policies and agreements such as the multi-fiber policy, Indo – Sri Lanka Free Trade Agreement, the 200 Garment Factories Program and the recently offered GSP+ Concession etc. also directly influenced the boost in this sector.

Today as result of the above measures there are over 850 registered garment enterprises in Sri Lanka and there are over 1000 SME level garment enterprises that contribute towards the development of the local economy.

The present-day income generated from this industry exceeds over 42% (approx: $3 Billion) of the country’s export earnings (Refer appendix – 03. Export structure Breakdown) and, on average, contributes over 45% of industrial production and around 6% of the GDP, thereby converting itself to become the highest foreign income earner for Sri Lanka. It presently employs over 350, 000 workers who account for around 15% of the country’s entire work force. Majority of these workers are females and therefore the industry plays a major role in women empowerment in Sri Lanka.

The Threat – Withdrawal of the GSP+ Scheme

Since early 2005 the local apparel industry has been facing various difficulties such as the withdrawal of the Multi Fiber Agreement in the year 2005, increased competition from low cost players such as China, Bangladesh, and India who are now more preferred as manufacturing destinations and the credit crunch which resulted in from the Global Economic Recession in the year 2008.

The GSP+ is a duty free export concession awarded to countries which fulfill the requirements set by the EU on good governance, compliance to international human rights conventions and labor standards.

On the 15th February 2010, the European Union (EU) decided to temporarily halt the GSP + concession which was extended to Sri Lanka due to violations of the EU agreement and causing further difficulties for the local industry.

Necessity for Value Chain Improvements

The impact caused due to the withdrawal of the GSP+ concession towards the sustainability of the industry is high as it has led to an direct increase in the purchase price (due to the enforcement of duty and additional tax payments made upon exporting) and thus has made local garment exports much more expensive than other exporters to EU countries.

This situation has led towards the contraction of the industry and has also threatened the infant firms (SME) as they are unable to obtain orders from the EU market due to the uncompetitive prices offered as a result of the import duty imposed.

Due to the above issue, industrialists today are considering to withdraw from this sector as it is losing its attractiveness in terms of profitability, return on investment and due to various other macro factors such as lack of government support, tight economic conditions with high borrowing costs etc.

Therefore it is time that all relevant parties looked into this matter in order to rescue the industry by providing various facilities required and suitable for an industry vision for the future which is focused upon value chain improvements in terms of quality, lean costs, reduced lead time in production and sustainability.

Furthermore organizational restructuring in terms of technology, techniques and infrastructure will also have to be incorporated into the vision of the industry in order to stamp a presence in the global market.

Potential Publications

A case based on the above issue faced by the local apparel industry has been produced and would like to seek publication in the following industrial journals or magazines.

## Sri Lanka Garments –

A Journal Published by the Sri Lanka Apparel Export Association (SLEA) on an annual basis and has a reader base of over 4000 apparel industrialists and investors. The journal mainly features valuable insights of the apparel industry covering areas of the export market, industry issues, future developments and trends. The editorial policy of this journal mainly stresses on the fact that articles pertaining to the industry would only be published subject to a prior verification on the credibility of sources and facts used by the author.

## LMD – Published by Media Service Pvt Ltd.

Lanka Monthly Digest, a local business magazine published on a monthly basis and currently has a reader base of over 20000 corporate and individual clients within the island. This magazine mainly consists of articles which relate to the local business organizations, Colombo Stock market performances and also features special articles based on a particular theme.

## Financial Times

This is a Daily Business newspaper which is published by the Wijeya Newspaper Ltd and currently has a mass reader base covering over 28, 000 households island-wide. This news paper mainly contains a comprehensive coverage of local and international business news.

Request for Publication

I personally believe that this article regarding the loss of the GSP+ Concession which I have forwarded for publishing would be a great value addition to your journal (Sri Lanka Garments) as this article explores a major issue which affects and threatens the industry. This article provides an alternate strategy on how the industry could recover from its current position as the country cannot afford to lose the revenue generated from this industry at a time when the economy is in a recession.

The following article features a significant issue which has emerged in our local apparel industry mainly due to political factors, and as a journal which analyses various issues regarding the apparel industry and the local market performance, this article would help market analysts to evaluate various issues pertaining to employment, trade condition, future demand and supply conditions etc in a more realistic manner which would enable them to explore the industry further.

Therefore, as a journal which is well known for its credibility, sound editorial policy and composition of a wide variety of articles pertaining to various apparel industry issues, I believe that my article merits publication as it addresses a significant threat relating to the industry in nature and needs to be communicated to all relevant stakeholders in the industry (Investors, Buyers, Government etc).

Word Count: 1067 words

The GSP Trade Concession

The GSP, also know as the Generalized Preference System is a special trade arrangement granted by the European Union (EU) where they are involved in providing special access to the EU market in forms of reduced tariffs and taxes.

The Generalized Preference System (GSP) is mainly provided to 176 developing nations for a period of three years and is an incentive that is granted with the objective of reducing poverty, providing sustainable development and to promote good governance. The total value of imports under the GSP amounts to around €58. 6 Billion and the nominal duty loss is estimated at over €2. 5 Billion as of year 2008.

Apparel and textiles, machinery items, minerals and gems, plastic and rubber items, footwear are the leading segments of imports which use the GSP scheme. (Refer appendix – 04. GSP preferential imports composition – 2007)

The GSP is provided to nations in three main forms,

Standard GSP: a general system which covers 6, 244 products and provides a standard preferential treatment which is given in form of reduced duty tariffs that is provided to all 176 nations.

GSP+ : this trade preference is provided to vulnerable nations which ratify and implement international conventions relating to human rights, labor standards, sustainable development and good governance. This preference is currently provided to 16 nations (refer appendix – 01. Countries covered under the GSP+ Scheme) including Sri Lanka and provides concessions to around 6, 336 products in terms of duty free coverage and reduced tariffs in specified taxes.

Everything But Arms (EBA): is a special quota and duty free concession provided to 7140 products except for arms and related items for the 48 least-developed nations.

## Situation of Sri Lanka

Sri Lanka (SL) is amongst those 176 countries which receive the standard GSP. However, in the year 2005, the EU decided to consider SL as a “ vulnerable state” based on its criterion and awarded the GSP+ scheme (refer Appendix – 02. Vulnerable nations) as SL’s export portfolio was limited in terms of diversification (refer appendix – 03. Export structure breakdown) and due to increasing levels of poverty which was further aggravated by the 2004 Tsunami and the 30 year long civil war. This trade concession further expanded business opportunities available, especially in the apparel sector within the EU region. SL managed to grasp them using the GSP+ scheme and thereby turn into one of the top 5 beneficiaries of the GSP+ scheme.

In the beginning of the year 2008, the intensity of the civil war began to increase and the country geared itself up with an aim to bring this conflict to an end. This move made by the government caused significant uproar within the international community and many allegations were leveled at the SL government accusing them on violations of the following treaties listed under the ratification list of the GSP+ scheme. (Refer Appendix – 02. Vulnerable nations)

International Covenant on Civil and Political Rights (ICCPR)

Conventions Against Torture (CAT)

Convention on the Rights of the Child (CRC)

These issues prompted the EU to appoint a special committee in October 2008 to investigate the level of compliance and ratification of human rights as it is a key obligation which needs to be fulfilled in order to receive the GSP+ concession. According to the committee’s report, three major violations of human rights was identified in terms of civil and political rights, torture and child protection.

Even though the SL government blatantly denies these allegations based on the reported findings, the EU Regulation council decided on the19th October 2009 to temporarily withdraw the GSP+ concession for a period of 6 months in order to rectify these issues.

The suspension of GSP+ Preference has directly caused a dent in political ties and international relations especially between United Kingdom and the other EU nations and the impact of this issue has extended itself into bilateral trade relationships between these nations and SL. As a result, the apparel segment, the footwear exports industry and agricultural exports have directly been affected.

The Loss of GSP+ : Impact on the Apparel Sector

## Industry nature

The apparel sector in SL constitutes around 1850 large, small and medium enterprises (SME) and currently employees over 350, 000 people directly and over 250, 000 indirect workers in terms of support services. The industry in SL has positioned itself as a core manufacturer and middle man in terms of value addition because the industry has specialized itself in carrying out manufacturing of the garment, whereas the buyer has to get the designs, fabric and all other input separately done. At present around 85% of the industry are in the export market business and the US, EU, Australia and Canada are some of the main clients of the industry.

The apparel industry attractiveness at the moment is on a declining phase due to increased competition, increased costs of raw materials, reduced government backing etc (refer – Appendix 6. Industry Analysis). This situation has been further aggravated by the removal of the GSP+ preference scheme due to various external factors explained above.

## Impact

Currently around 50% of the apparel export is purchased directly by the EU and SL at present holds around 1. 6% of market share of the total EU market. China dominates the market with over 46% of share and is followed by Bangladesh which holds around 13% of the EU market (Refer – Appendix No 7. EU Market share analysis). Therefore, due to the suspension of the GSP + preference scheme, the local apparel industry is directly faced with a threat of losing its market share to other competitors in the EU market.

## “ If GSP were to go away, it is this excellent and compliant industry that will be hurt very badly. The effects would see the rural economy facing hardships and women employment and empowerment would greatly be damaged”

– Mr. Kumar Mirchandani. President – SL Apparel Exporters Association.

The re-imposition of the trade tariffs would directly make the SL manufacturers apparels more expensive to the EU market and thus would directly place the SL apparels at a competitive disadvantage. At present, SL is the highest priced EU apparel exporter (refer Appendix – 5. Average Prices of garment imports to the EU) and due to this situation apparel exports to EU within the 1st Quarter of this year has declined by 18% and thus paving the way for global competitors such as China, Bangladesh, Vietnam who are well known for their lower priced apparels with an opportunity to directly benefit through this situation.

The limited diversity of the SL apparel exports in terms of markets have also contributed adversely to this situation. At present the revenue generated from this industry is estimated around $3. 4Bn and 90% of this turnover is generated through the US (44%) and EU (46%) markets. Thus an increase in prices within the EU would be an extreme sensitive issue as it would directly contribute towards a decline in turnover levels and thus result in a loss of market share.

Furthermore when considering the necessity to increase prices, SL manufacturers pose little or no power in terms of bargaining mainly due to the market structure which dominated by strong competition. (Refer – Appendix 6. Industry Analysis)

Therefore, the withdrawal of GSP+ alongside the other industry problems such as increased labor costs and regulations, energy costs, reduced government facilitation and increased financing costs have made this industry a difficult one to operate in with many uncertainties which need to be addressed promptly.

Value Chain Improvements

Since a price increase would be detrimental to this sector, most of the SL apparel manufacturers will have to face the GSP+ challenge through considering options on internalizing the increase in tariffs with specific changes to their value chain through cost and margin improvements.

Special emphasis needs to be placed on the SME segment because in an industry where SME constitute the majority, it is imperative to ensure the sustainability of these firms as they are directly connected to the rural economy of SL and are also key players in empowering women. SMEs also play a vital role in the industry by providing various support services for large firms and thus indirectly ensuring their sustainability.

However it is this segment that faces most of the adverse consequence since their ability to manage change is limited.

In order to overcome this situation, all firms should focus more on their primary functions specially relating to manufacturing and logistics segments which could be vastly improved using technological innovations and infrastructure support. Investments in these areas would enable firms to increase their margins as they will be able to benefit from economies of scale, increased efficiency and reduced overhead costs.

Ex: Adopting the usage of a Computer Aided Design (CAD) system in the process of cutting fabric. Remove capacity bottlenecks by investing on latest machinery and equipment.

Larger firms would view this option more feasible due to their strong financial background where as the SME sector will face difficulties in coping up with this move due to financial constraints.

Ex:

MAS Intimates – the leading apparel exporter in SL opened its first custom built ECO – Factory for Lingerie manufacturing in the year 2009.

Hirdarmani Group (SL) investment in state of the art garment engineering technology.

Additionally, firms should also attempt to stream line their value chain by enhancing value adding activities such as improved quality levels, lead times etc. and also by focusing on removing and reducing non value adding activities such as raw material wastage, idle labour and machine hours, rejects and reworks etc.

The implementation of basic 5 S principals, Continuous improvement techniques (KAIZEN), standardization and total quality management principals would directly enable firms to benefit from increase yield, productivity and a lean cost structures which would directly facilitate improved margins.

The 2nd option mentioned above would be more encouraging to the SME segment because unlike the earlier option the financial resource requirement is far more less and it is also more convenient for SME owners to implement and monitor.

Furthermore, firms should invest on employees by providing them with adequate training and development in order to enhance their skills and learning rather than considering lay-offs. This would enhance employees performance and motivation levels and would also enable firms to develop a strategic asset which would deliver long term sustainable margin improvements.

Changes in Marketing Professional’s role

## “ Sri Lanka is at the point of a great resurgence and the UK acknowledges that there is great potential in the region as well. This means that marketers have stronger challenges here than elsewhere in the world. In order to capitalize on the opportunities that are emerging from other countries in the region, marketers in SL have to develop themselves”

Mrs. Janet Ford. Head – British High Commission Trade and Investment.

Marketing at its basic level is essential to driving revenue, pushing the bottom line and satisfying customer needs and as marketing professionals in the apparel segment, it is important for us to move out from our comfort zones and engage in this new paradigm of business which is constantly facing change.

In order to ensure this transformation, the real essence of marketing should be practiced at its highest level in line with organizational objectives and customer needs thus requiring marketers to be more proactive in the industry.

Hence, marketers should take the initiative and develop a difference by promoting their corporate identities within the segments they operate in (especially in the export market) because this would enable firms to develop equity in their organizations and would also help increase their bargaining power.

Marketers should also persuade and negotiate specific deals which incorporate new ventures, partnerships that would enable the firms in the industry to sustain and mutually benefit themselves in the long term (Ex: MAS Intimates partnering with NIKE, Victoria’s Secret, Speedo and GAP). Strong communication and negotiation skill would be vital for a marketer when convincing partners with a business case and negotiating deals.

Additionally, marketers should also take the initiative and act in the capacity of a change agent by introducing new trends, technological advancements and improved production techniques into the business in order to develop a competitive advantage to successfully maneuver this function, a marketer would require strong leadership and change management skills in order to convince and incorporate these innovations.

Furthermore in terms of skills, a marketer also needs to possess sound finance, commercial and technical knowledge to enable him/her to develop a better judgment in decision making and also to justify his/ her case when interacting with customer, cross functional teams and various other stakeholder queries.

It is also important that a marketing professional in the SME sector ensure that they change their organizational scope from a traditional sales/product oriented organization into a marketing oriented organization which would ensure the development of a separate marketing function that will enable the organization to actively participate in promoting their products and identities.

Therefore, these behavioral changes and improvements in skills would enable marketers in this field to broaden their thinking and enable them to face and adapt to any environmental challenges successfully.

The Way Forward

It must be noted that trade concessions in nature are more focused upon the short term development of the industry. Firms cannot depend on them forever and they need to strategically utilize them to build up resources while they are available to develop and establish themselves in the market.

Therefore, instead of depending on trade concessions such as GSP+ to battle out competition the industry needs to focus on continuous improvements in terms of production, quality, technology etc. to outrun other players compelling the marketers in the industry to take the lead role in actively participating and introducing new trends, technology and developing partnerships with leading brands in order to ensure the sustainability of the industry.

## Word Count: 2200 Words

Appendix

## 1. Countries covered under the GSP+ Scheme

Armenia

Azerbaijan

Bolivia

Colombia

Costa Rica

Ecuador

El – Salvador

Georgia

Guatemala

Honduras

Mongolia

Nicaragua

Paraguay

Peru

Sri Lanka

Venezuela.

The above countries are covered for a period of three years (2009 -2011).

Presently Sri Lanka and El – Salvador have been temporarily withdrawn from the GSP+ beneficiary list due on going investigations pertaining to human rights violations.

## 2. Vulnerable Nations

In order to be classified as a vulnerable nation the following criteria needs to be satisfied.

Any country should not be classified as a “ high-income or developed nation” and where its 5 largest section of its GSP covered imports are more than 75% of its total GSP covered imports, and

Where its GSP covered imports are less than 1% of the total GSP covered imports.

Ratification and effective implementation of

16 core human and labor rights and 11 environment and good governance conventions.

(Ex: International covenant on Civil and political rights, forced compulsory labor convention, Kyoto Protocol, Mexico Conventions against corruption etc.)

Sri Lankan situation based on this classification

## 3. Export structure breakdown

## 4. GSP preferential imports composition – 2007

Note: It is clear that over €13Bn (22%) of apparel imports to the EU in the 2007 is done under the GSP preference Scheme.

## 5. Average Prices of garment imports to the EU

Note: Even before the withdrawal of the GSP+ Preference scheme the SL export price per Kg of apparel was the highest at €15. 91 amidst other competitors.

## 6. Industry analysis

The attractiveness of apparel industry can be analyzed as follows using the 5 forces frame work which was developed by Michael Porter in the year 1979.

## Barriers to entry – Low

At present there is no significant barrier to entry. Any investor willing to enter the market could do so. The Export zones and the industrial zones which are established around the county can be considered as added incentives for new entries into the market.

## Competition – High

Competition levels can be evaluated in two aspects.

Local – competition within the industry is at a higher level as there are vast number of players (1850 garments) involved in this industry to cater towards the export market.

International – Competition levels on a global scale is also at a higher level and is mainly dominated by low cost manufacturing nations such as China, Bangladesh, India, Vietnam etc.

## Bargaining power of customers – High

Customers do have the privilege of demanding a better bargain out a deal due to the vast availability of many other suppliers in the market.

Ex- If a SL manufacturer proposes for a price increase the customer could easily refuse it and place the order with another supplier (locally or internationally).

## Bargaining Power of suppliers – Medium

Most of the input within the industry is imported and in most occasions it is only the labor component which is sourced from the local market.

## 7. EU Apparel Market share Analysis

Sri Lanka at present holds around 1. 6% of the EU market which is clearly dominated by the Chinese and Bangladeshis who holds cumulative share of 62%.