

Sri Lanka's Apparel Industry: Post-MFA Challenges and Beyond

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Key words: Multi-fibre Arrangement, Sri Lankan apparel industry, value chain, small economies, outsourcing, industrial restructuring, ethical production

Background

The phasing out of the Multi-Fibre Arrangement (MFA) that took place 1995-2005 had been the most critical challenge Sri Lanka's apparel industry (SLAI) faced in its four decades of existence. The MFA that came into effect 1974 signified the beginning of era of apparel exports growth at exponential proportions. Whilst a nation-based export quota system of the MFA led to a dramatic reconfiguration of global apparel market operations with a defragmentation of the apparel value chain, investment flows to developing countries soared and many became apparel producers.

The phasing out of the MFA protection, first via the Agreement on Textile and Clothing (ATC) and then the World Trade Organisation (WTO), exposed the apparel trade of many developing countries to a state of affairs different from what existed before. Under the post-MFA rules of engagement, many countries were exposed to the vagaries of global competition, and many predicted that the gains made so far by those countries under the MFA protective umbrella would potentially be reversed. The most vulnerable were the small economies like Sri Lanka, which lacked inputs such as economies of scale, backward linkages, competitive wages that were critical to survive competitive global forces. As predicted, producers with superior infrastructure and low costs made huge strides at the expense of several high cost producers, small and marginal players. Defying the widely held odds however were few countries that managed to maintain their status quo, and some even made significant export growth (Adhikari and Yamamoto, 2007).

Few studies have analysed the performance of the SLAI in the post-MFA era and the strategies adopted but the outcomes of these studies remain mixed. Broadly, the SLAI maintained its growth, with the latest in export earnings in 2011 at US\$4.2b, which reflects an annual average growth of 8.3% during 2005- 2011 period in comparison to close 5% during the 1995-2005. On the other hand, the global share of the Sri Lankan apparel export earnings fell from about 1.4% in the 1990s to around 1% in the 2000s. While these figures reflect SLAI vis-a-vis global apparel trade, they however, do not bring out the most dramatic processes that took place within the industry as it restructured and repositioned itself to face an intense global competition.

Objective

This study aims to ascertain whether the SLAI substantially defied the post-MFA outcomes predicted for small economies. It examines how the SLAI performed, readjusted as it came under intense competitive pressure from sourcing firms, and also how the industry realigned to face the emerging realities. The study examines these aspects by focusing on the emerging trends in the post-MFA years, especially the structural shifts in markets and products. The study also examines the remaining gaps and the challenges and direction of the future. Findings of this study are to be used to lead an in-depth study of the SLAI that will profile the emerging industry and aid policy recommendations for its future.

Methodology

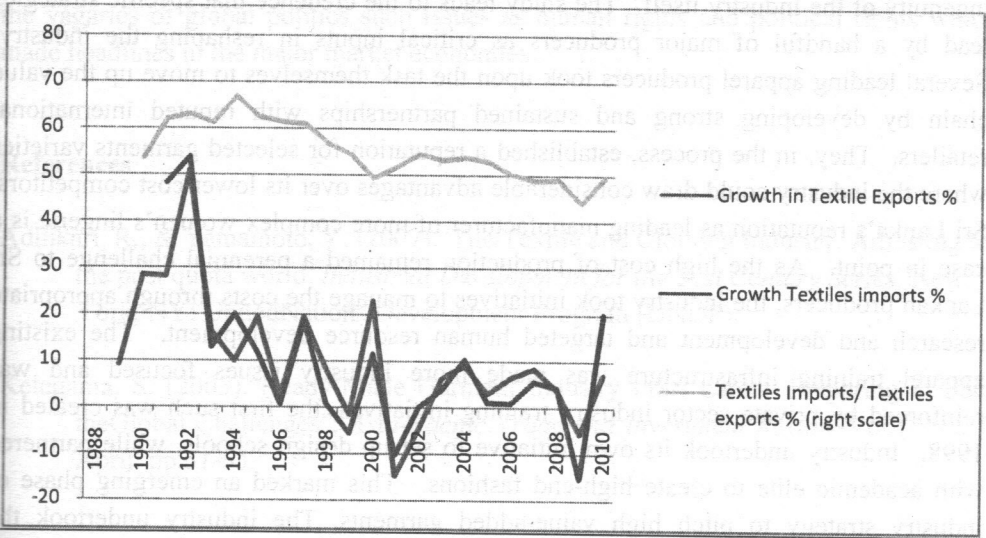
The study was based on two tiers of data and information: namely the secondary data obtained from a multitude of sources, including Sri Lanka Customs, Sri Lanka Export Development Board, Joint Apparel Association Forum, and un-published firm level data; the second tier of data are gathered from primary sources as firm-level qualitative information. Notwithstanding that the SLAI data have been most elusive to retrieve, firm-level qualitative information assessment was also used to fill information gaps, ascertain the issues faced and counter strategies adopted. The firm-level information from 10 companies, that represents a cross section of the industry, was targeted where senior officials at strategic level, and mostly Chief Executive Officers, were interviewed to gather information on the industry at micro level.

Summary of findings

The evidence suggests that the SLAI has gradually shifted from its reliance on several factors that provided the basis for its expansion in the MFA. For instance, low-end apparel supply chain access through low wages, concessional trade practices, reliance on few markets/ few products were considered things in the past. Also, the industry clearly has embarked on self-restructuring and self-initiatives in contrast to highly state policy dependant culture that dominated the MFA years. Most notably, industry through its market based initiatives have begun exploring innovative strategies to mitigate inherent odds, most notably lack of a sound backward linkages network, relatively high labour costs, etc.

The Figure 1 provides evidence of an emerging trends to how the local value addition has made commendable gains in the post-MFA years. Notably, textiles imports share in apparel exports has registered decline, from over 60% in the 1990s to below 50% in the latter half of 2000s.

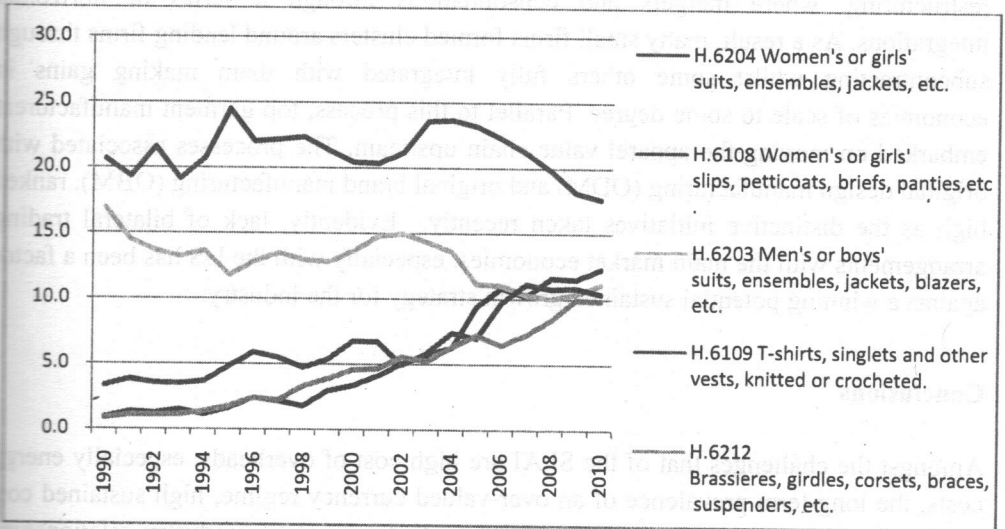
Figure 1 : Value addition in the post-MFA years



Source: CBSL Annual Reports, various issues

As can be seen in the Figure 2 below, the diversification of apparel exports that began in the late 1990s intensified in the second half of the 2000s. These export product diversifications reflect industry response to an emerging global trends and how it created competitive advantages.

Figure 2: Diversification of apparel exports



Source : Sri Lanka Customs data

The survival of the SLAI in the post 1995 phase seems most attributable to the ingenuity of the industry itself. The study leads to the credence that specific strategies lead by a handful of major producers as critical inputs in reshaping the industry. Several leading apparel producers took upon the task themselves to move up the value chain by developing strong and sustained partnerships with reputed international retailers. They, in the process, established a reputation for selected garments varieties where the industry could draw considerable advantages over its lower cost competitors. Sri Lanka's reputation as leading manufacturer of more complex women's lingerie is a case in point. As the high cost of production remained a perennial challenge to Sri Lankan producers, the industry took initiatives to manage the costs through appropriate research and development and targeted human resource development. The existing apparel training infrastructure was made more industry issues focused and was reinforced by private sector industry training initiatives, the first such was created in 1998. Industry undertook its own initiative to set up design schools, while partnered with academic elite to create high-end fashions. This marked an emerging phase of industry strategy to pitch high value-added garments. The industry undertook the challenges as a collective responsibility, and this paved the way to the creation of the Joint Apparel Association Forum. The SLAI consolidated this opportunity to access EU market under the GSP granted in 2004 further by strategically positioning by adopting ethical manufacturing standards, which found an appealing position in the EU market. Evidently, while the ethical positioning through the "Garments Without Guilt", though did not create higher margins for exports, it indeed sustained export order volumes over Sri Lanka's competitor countries. Across the SLAI, however, the phasing out of the quotas had serious implications, with many small producers and also several large manufactures closing down. The industry responded to this challenge by market-based restructuring, where mergers and consolidations through a series of horizontal integrations. As a result, many small firms formed clusters around leading firms through subcontracting whilst some others fully integrated with them making gains in economies of scale to some degree. Parallel to this process, top garment manufacturers embarked on moving the apparel value chain upstream. The processes associated with original design manufacturing (ODM) and original brand manufacturing (OBM), ranked high as the distinctive initiatives taken recently. Evidently, lack of bilateral trading arrangements with the main market economies, especially with the US has been a factor against a winning potential sustained growth strategy for the industry.

Conclusions

Amongst the challenges that of the SLAI are high cost of overheads, especially energy costs, the long-term prevalence of an over-valued currency regime, high sustained cost of financing and, domestic wage rigidities fuelled by volatile industry relationships were identified as further drag on the industry growth. The adverse situations were

further compounded by apparent State apathy to address national economic issues and the vagaries of global politics such issues as human rights and political rights which made headlines in the major market economies.

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