



IMPACTS OF THE GLOBAL ECONOMIC CRISIS ON THE GARMENT SECTOR - FINDINGS FROM BRAND AND RETAILER INTERVIEWS

- MFA Forum Briefing: June 2009 -

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Summary: Key Trends

- **Ongoing consolidation** – Retailers and brands had been consolidating towards fewer, bigger suppliers in the post-MFA period. The recession is speeding this up.
- **Mixed fortunes** – Many brands and retailers (but not all) are cutting orders. Those selling into North American markets in particular have cut their order volumes considerably. Those that are cutting orders say that this is taking place across their supply base, but the balance of orders in general is continuing to shift away from suppliers in Central America, Turkey and North Africa towards those in East Asia. However clothes are still being made and factories in some countries are receiving expanding orders even as others are decreasing production.
- **Maintaining supply chain stability** – Companies are seeking to maintain stable relationships with strategic vendors; attempting to spread cuts in orders across all of their strategic suppliers to enable them to see out the downturn. Increasingly buyers are managing their supply chains by selecting vendors while vendors select countries to manufacture in.
- **Price pressure?** - Although they are cutting orders in line with lower sales, the companies said that they are not using this as an opportunity to push down prices or lead times, or to push up payment terms, because they are aware of the vulnerability of their suppliers and the need to retain a stable supply chain for the future. However the product mix is shifting more towards price sensitive core lines and promotions meaning that orders are shifting towards lower cost suppliers and away from higher value added suppliers.
- **Suppliers and jobs at risk** - All said they were aware of factories closing, with suppliers in China, Pakistan, Mexico, Sri Lanka and India in particular being mentioned. Key factors mentioned were falling orders, but also lack of credit and competition and overcapacity in the industry with smaller factories and sub-contractors closing down, while larger suppliers are expanding. Most said that where they have to divest from factories they do this with a period of notice, or following several seasons of gradual reductions.
- **Impacts on workers** - CSR and compliance managers within each company said that they are alert to the risk of negative impacts on workers still in work, and highlighted falling wages (due to cuts in hours and discretionary benefits), delayed payment and irresponsible retrenchment (e.g. on an anti-union basis or without severance pay) as key issues.
- **Monitoring and mitigating impacts** - None of the companies were able to accurately assess the level of job losses in their supply chain, but all are keeping a close eye on financial viability of suppliers and whether lay-offs are done properly. Some companies reported increased requests for them to provide funds up front, or guarantee credit.
- **Predictions** - Most companies predicted that things would get worse before they get better in terms of general retail demand and sourcing volumes. However while many suppliers and factories remain vulnerable, buyers were not painting 'winners and losers' scenarios at a country-by-country level.
- **Information needs** - Interviewees agreed that it was useful for the MFA Forum to share this information but noted the difficulty due to commercial sensitivity and the rapidly changing situation. Information sharing also needs to move below the international level to get transparency around the state of communities and supplier vulnerability and to support local action.



Introduction

As outlined in our previous briefing on Global Trade Trends (March 09) the credit crunch and downturn in consumer spending is resulting in falling global export volumes in the apparel, footwear and textiles sectors for the first time for many years. In exporting countries factory closures and job losses are reported, with the ITGLWF estimating that 11.5 million jobs have already been lost.

However, there are many conflicting reports and predictions on the extent of the trade and employment impacts, and while official trade data provides a fairly reliable picture of global supply chain shifts, it can only provide a backward looking assessment and does not capture the impacts in terms of factory closures, worker layoffs or poverty risk. Lack of good information is a critical barrier to effective collaborative action.

This briefing is based on interviews, email conversations and data provided by ten companies in the sector, including European, North American and global retailers and ranging from mass-market to luxury brands. Interviews were carried out in between April and June 2009 with social responsibility or compliance managers who were in close touch with buying and production teams.

Key trends

Ongoing consolidation

Almost all of the companies reported that well before the economic downturn they had already been in the process of supply chain consolidation following the end of quotas. Although for some this meant reducing the number of supplier countries and regions in order to consolidate their own buying teams, the main driver has been to reduce the number of vendors to fewer, larger and more professional full-service businesses.

In general the long-term shifts reported confirmed those already revealed by aggregate trade data; falling orders to many countries in Central America and shifts away from countries where the price points are rising such as the Philippines, Thailand, and Turkey towards China, Vietnam, Cambodia and Eastern Europe – although in some cases, such as in Turkey high street brands are being replaced by more upmarket niches.

For some companies the recession hit at a time when they had already completed substantial supply-chain consolidation programmes and had stabilised around 'the supply chain we want', for others still part way through consolidation processes, the recession has speeded up the process.

"We have been realigning our supply base, to meet compliance and quality requirements, it is an ongoing process which was in place before the recessions and it is not completed yet."

"A lot of brands are consolidating, they have been anyway, never-mind the recession. They are switching away from smaller suppliers towards more strategic ones."

"We had consolidated our suppliers so the number has remained stable in the past couple of years. Our overall strategy is to reduce the number of suppliers to larger, more capable ones. We have also sought to reduce the number of countries we source from but retain regional diversity to maintain a balance of speed to market and lower cost basic suppliers."

"We are continuing to consolidate our vendor base in line with our ongoing plans. But some of this has speeded up."

"Before there was no strategy. So we organised, focused on a few countries, rather than buying from a multitude of countries. We made a strategic decision to consolidate, put people on the ground and focus on five countries."



While few reported that the economic crisis has forced a completely unplanned consolidation some say that they have had to divest or cut orders from factories where previously expansions had been planned.

Mixed fortunes

The majority of companies reported that they have been reducing the volume of apparel, textiles and footwear orders in the past six months, in response to a combination of falling sales and a desire for tighter inventory control. Overall cuts in order volumes of between 15 and 50% were reported by those who had cut orders. But others also reported stable or increasing volumes of orders.

All companies reported that there is no strong regional focus in supply chain shifts at this point, with cuts being spread across supply chains:

“Global contractions hurt everyone”

“We are making significant reductions across the board in major sourcing countries, both in close to market sourcing where reduced production can have an immediate impact on our inventories. But we have also made volume reductions in lower cost, further from market suppliers as well.”

“We have been growing, not reducing business, but there are potential shifts in where we do business – but this is about selecting vendors not countries.”

“We are looking for a specific type of supplier – we work primarily with big, strong, diversified, vertical suppliers. Allow them to manage the relationship with their own network of suppliers.

“The supply chain so far hasn’t changed very much so far. There has been a concentration of factories, but not of countries.”

“In 2008 our orders fell through a combination of sales falls and inventory reductions – some countries are back to where they were in 2005. It is a rebalancing – it hasn’t been cataclysmic.”

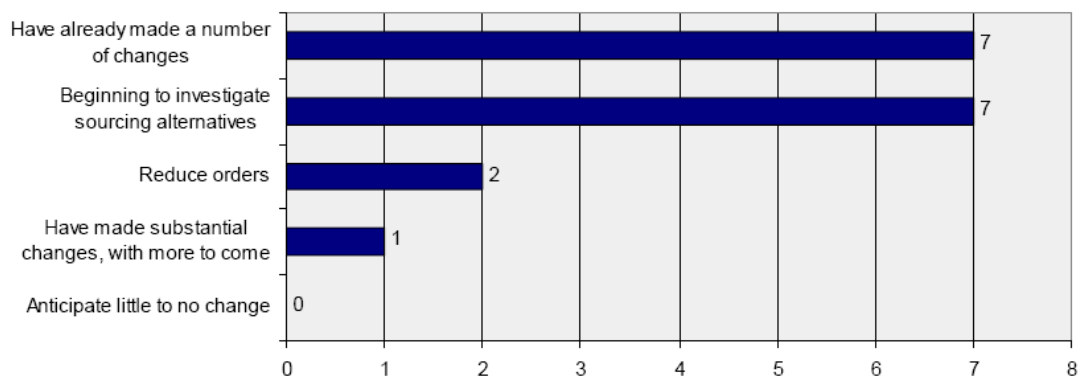
“The smaller factories are getting hit the hardest, because they don’t have the resources for social compliance, systems, quality etc... the bigger companies are getting more business. Our country mix hasn’t changed much, but the number of suppliers is going down. “

However, the sourcing cuts are tending to continue the ongoing shift away from suppliers in Central America, Turkey and North Africa towards those in East Asia. Although companies were not able to share comparable hard data, many mentioned the most recent trends in relation to orders from key countries. As the summary table below highlights there are mixed fortunes within supplier countries as well as amongst retailers, with factories in some countries receiving expanding orders even as others are decreasing production.

Countries mentioned			
Reports of rising orders	Reports of stable orders	Reports of cuts of less than 50%	Reports of cuts of more than 50%
China Bangladesh Cambodia Turkey Indonesia	China Bangladesh Pakistan India Indonesia Central America Middle East Turkey Vietnam	China Sri Lanka Nicaragua Cambodia Indonesia Egypt Pakistan Dominican Republic Bangladesh Turkey Eastern Europe India Vietnam Indonesia Sri Lanka	India Madagascar Lesotho Mexico China Dominican Republic Peru

These findings are also reflected in a survey by BSR of 19 brands and retailers amongst their (mainly North American) membership, which found that most have either made some sourcing changes as a result of the economic downturn, or were planning to make changes, but few had reported 'substantial changes' in their supply chain.

Expected Impact of Economic Climate on Sourcing Plans



[Source:BSR]

Maintaining supply chain stability

Every company emphasised that their key relationships are with vendors; agents and factory groups often with international operations and multiple production sites. Many said that at this stage they are seeking to spread the burden of cuts across all of their strategic suppliers in order to enable as many as possible to stay in business through the downturn.

“We spread orders to keep people in business, but if the cuts get too great then you are making everyone vulnerable to failure rather than just a few. The Americas is a challenge for us – we want to stay in Mexico and Honduras for geographic reasons. But we don’t find the kinds of big, strong innovative suppliers we want there.”

“We have tried to keep all our suppliers ticking over – spreading orders across to keep them going. That is also the advice we give to our vendors, in terms of managing our broad supply chain through them.”



“Rather than use this to reduce the size of our supply base we are trying to spread the cuts around evenly. The suppliers we have are the suppliers we want. So we are trying to preserve the supplier base that we have – we want to keep 100% of suppliers that we have. We are trying to keep them all.”

While relationships between brands and strategic vendors may hold steady, many report that their suppliers themselves are shifting manufacturing bases between countries, or that agents with whom they have relationships are moving.

“One of our suppliers had moved out of Greece and Albania to Turkey. Now it is moving from Turkey to Egypt. Thai manufacturers are trying to diversify their risk by, moving into to Cambodia. Some manufacturers are still looking for the last frontier of competitive rates – some are looking to shift to Laos. In Morocco we weren’t big to begin with, but we were using an agent there and the agent is pulling out.”

“Our vendors are doing more of the design and development. We work with them on direct development and they give us a true price. So we go where our partners go, not on our own. “

Price pressure?

Although they are cutting orders in line with lower sales the companies said that they are not using this as an opportunity to push down prices or lead times, or to push up payment terms, because they are aware of the vulnerability of their suppliers and the need to retain a stable supply chain for the future.

“Prices are not coming down. The contractors that we have are the ones that we want to retain long term relationship with.”

“We had been planning to extend our payment terms from 45 to 60 days, before the recession. But our suppliers told us that this would make them vulnerable, so we decided to stick with our existing 45 day payment terms.”

Many companies reported that their customers are now more focused more on price, leading shift their product mix towards core products and value lines, and away from value added value lines. This has meant that orders to countries such as Bangladesh and China have remained stable or even risen for many companies.

Suppliers and jobs at risk

All said they were aware of factories closing, with China, Pakistan, Mexico and India in particular being mentioned. Key factors mentioned were:

- **Falling orders** – while most companies said they were spreading cuts amongst all their suppliers, factories operating at well below capacity are in danger of closing. Footwear and sporting equipment in particular were mentioned as being most vulnerable.
- **Lack of credit** – brands and retailers agreed that their suppliers are feeling the credit squeeze and that this was often the key risk factor for factory closure. Most are aware of some suppliers who are having difficulty securing credit to buy raw materials. “The full-service model that we have moved to puts a lot of risk in the hands of suppliers. Access to credit is crucial” “ Our suppliers tell us that their suppliers want to be paid in cash and at short notice, for trims and labels etc..., because they have seen customers going bust . It is more difficult for suppliers to get money from the bank to make investments”.
- **Weeding out of underperforming suppliers** – some brands and retailers said that there had been an over proliferation of factories, which was now being levelled out by the downturn “The ones that are tending to fail are the overstretched and overleveraged, the ones with less working capital. The ones without a diverse customer base. The ones with overall poor management.”

There were surprisingly few direct reports of factories closing overnight, with workers left unpaid. “We are seeing fewer closures in our supply base than we hear about anecdotally. We think it is because of the way we select our suppliers. Those that do well at compliance also do



well at other things. We also monitor legal payments. When they miss payments it is a compliance violation – so we pick up on it in advance. We have better line of sight to our suppliers and are at less risk of failure.”

“In Sri Lanka some of our suppliers have gone bust. But they had good labour relations. Workers felt like part of the company. Workers knew the supplier was trying to stay in business as long as possible and there was not a lot of backlash.”

Where companies did report these types of closures in their supply chain they say it is affecting smaller factories and sub-contractors, and also those outside of the garment sector (‘hard lines’), there were no reports of closures affecting major vendors. One company wondered whether ‘midnight-flight’ closures were less prevalent than it appears, since it is the worst example that get the most publicity, while closures done legally do not make the news.

Most said that where they have to divest from factories they do this with six-month to one year’s notice, and/or cut down on orders gradually. However they noted that this is not standard practice across the whole industry.

“Mostly when we are making a significant reduction, the factory is able to fill it with other orders. So there are not so many layoffs. Sometimes we find out afterwards that a factory has closed – then we go and check that everything has been done properly. We don’t get caught out like this often, but when it does happen sometimes we have so little influence we are unable to do anything about it.”

Some said that alongside factory closures they are also seeing expansion amongst some suppliers “Some of our suppliers are expanding, using this opportunity to take on more skilled workers – we are seeing this in Cambodia and China “

Impacts on workers

CSR and compliance managers within each company said that they alert to the impacts on workers and highlighted particular issues:

- Number of hours are being reduced so excessive overtime or unpaid overtime is not a problem at the moment, but living wages are. “We did some research with our suppliers in Vietnam and China. In Vietnam we found that take-home wages had gone down because there is less overtime and less bonuses. In China they are laying off staff and keeping wages at the same level.”
- Increasing insecurity of the industry is translating into delayed payments to workers, and more use of contract workers and sub-contractors. “Suppliers are more and more overselling their capacity, because there is so much insecurity. Make many offers, but if they all come in there are problems. So leads to sub-contracting without informing us.”
- Some suppliers have cut discretionary benefits.
- There is a major concern that people are being retrenched on anti-union basis.

One company also reported that they are seeing an increase in quality problems across the board “Suppliers are not having so many supervisors, not training on new product requirements – quality problems that is where it is showing up. “

Many commented that it is smaller factories that are retrenching and closing, because they do not have the systems and capacity to remain viable, and it is workers these workers who are most vulnerable.

Monitoring and mitigating impacts

None of the companies were able to accurately assess the level of job losses in their supply chain, particularly where they are sharing manufacturing facilities with other brands. Major brand said that job losses were ‘in the 1000s’ or estimated on the basis of their overall volume reductions – with one company estimating 120,000 jobs potentially at risk across their supply chain. However most interviewees indicated that in many case job losses and closures were happening beyond their first tier of strategic suppliers, and were not directly to related to their



specific divestment but to the broader market. Therefore most interviewees said that they had little visibility or monitoring of these impacts on workers.

“We don’t have any quantitative visibility into labour impacts. We have been looking at how to get a better handle on it. We do audits once a year at site level and will record how many employees there are. But it is not real-time data. Some companies only go into a third of their factory base, once every two years, so as an industry there isn’t good data here.”

“When we visit we see that around 20% of factories have reduced the number of workers they have because of general orders diminishing. But if we are only taking a small share of the factory’s production it is not something we are proactively monitoring.”

“ There is much more unemployment in Southern China. Before there was a shortage of workers. Now, no suppliers there are telling me they are shortage of workers.”

All are keeping a close eye on their strategic suppliers to monitor financial viability and to ensure that lay-offs which do happen are done properly

“We have been assessing supplier’s financial health assessment even before the crisis. Even some of our best players have a poor understanding of financial management. The greater the distance between you and the management, the more likely it is that you don’t know what is going on. In preparation for lay-offs we do monitoring at the supplier to make sure they are financially in position to pay severance. And we monitor that they get paid. “

“It is all the more important that we maintain close relationships with our suppliers, pick up the phone, meet together, so that we can see challenges before they hit.”

Some companies reported increased requests from suppliers for them to provide funds up front, or guarantee credit. In some instances companies reported extending credit, directly investing in vulnerable but strategic suppliers, or providing post-shipment financing in partnership with banks. However all companies who discussed this were reluctant to step in further into this area as it represents a move away from their competitive model of strategic sourcing and concentration on design and marketing.

“We have been moving away from letters of credit for many years. Normally in mature industries – you place an order, and then pay the invoice in arrears. Letters of credit are a legacy, more important for suppliers who can’t get credit. We want to work with suppliers who are multinationals in their own right.”

Predictions

Most companies predicted that things would get worse before they get better in terms of general retail demand and sourcing volumes. However while many suppliers and factories remain vulnerable, buyers were not painting ‘winners and losers’ scenarios at a country-by-country level.

“This is still a fluid industry. Whenever I think I know what is going on in terms of the big picture, our buyers come back again and say we are planning to try again with growth in Mexico, the Dominican Republic or other countries we had been reducing in. Or they say they are cutting orders in some place where they had been growing because someone missed a shipment. Some of this stuff is big picture and some is about individual businesses involved. It is not a massive stampede from country to country. It is messier.”

“Bangladesh is betting on more business coming in the next 18 months. India has never really made it. We are still waiting for the India awakening. It has been flat for the past 5 years. But exchange rate is now a bit more favourable. Sri Lanka will heavily benefit from the end of the civil war. Is better now, short lead-time. They are building green factories, more ethically savvy. Where 5 years ago I was thinking of closing the office in Sri Lanka, not now. Turkey is expensive, but business is going back to Turkey because of short lead times. The rest of countries are small, they cannot absorb many factories. But we will still source there if there are good suppliers. Indonesia may get more business, if it becomes politically more stable. It looks like a good place for a garment industry. In a leaner way than what happened in Vietnam. China will restart. It didn’t stop. The government. is massively investing in infrastructure – highways,



incentives for factories to set up in new provinces. They are also seeking for suppliers to move to Northern provinces and out of the cities.”

Some companies discussed the possible shape of the future of apparel and textile trade – with greater emphasis on markets in China and other developing countries, better inventory control and cost control and fewer mark-downs.

“Our stores in Asia are growing too, stores in China, Asia. But too early to say how the volumes will look like but our business is not linked to one country.”

“We are still trying to refine the sourcing model – space orders better. Rather than one big order we will make 3- 4 orders through the seasons. We try to work with suppliers on booking of capacity and agree what is the last possible deadline, to have a better flow of stock.”

“We have been reducing volume orders for quite some time – looking to reduce inventory and have greater full price sales. In the uncertain market this is a better strategy”

“People will plan their buy now based on current volume levels, It is a chance to reset, to control inventory. The market will improve, but it won’t bounce back. Consumer spending won’t bounce back. For us our great strength is diversification. China may become our biggest market.”

Information needs

Interviewees reflected (although not conclusively) on the different types of information that it might be useful for the MFA Forum to collect and share:

- **Mapping aggregate trade trends data as well as available information on unemployment and poverty impacts** is useful to provide a sound basis of information, to pull together the big picture and put discrete data into an understandable narrative. “Shocking statistics are very helpful in terms of motivating people to action. It is not something that individual compliance staff have time to pull together.”
- **Sharing information around current sourcing and plans** is desirable, particularly for informing discussions with IFIs. But it is difficult because of commercial sensitivity. It was also notable that no company was able to field questions directly with sourcing staff, although CSR/compliance managers were able to comment on general sourcing trends and plans. The general feeling was that companies will not share this information in writing or in an online survey, but will do through a verbal process of periodic interviews or round table discussions.
- **At a country level need to get transparency around the state of communities** – where else are factories going out of business in the area, what are the other job opportunities, as well as identifying which suppliers that are vulnerable or needing credit.
- **Mapping government responses** – this could be useful both to help companies in understanding vulnerabilities in the supply chain and signalling to governments that businesses are looking at the broad picture when considering country competitiveness. “Where governments do nothing to help the industry it may not be somewhere we will invest in with confidence”
- **Information on international frameworks** – consolidate information on international funds and initiatives, policy declarations, and relevant global frameworks.

However they were clear that research and information collection should be prioritised and targeted to support action by the Forum “We can always call for more information but we are at a stage where we have to figure out what are we actually going to do.”