

SRI LANKA APPAREL EXPORTERS ASSOCIATION

NEWSLETTER

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NEWS IN BRIEF

Redesigning apparel manufacturing in Asia: A pattern for resilience



Apparel manufacturers need to focus now on transforming themselves to succeed in the short term and be future-ready and competitive for when the market situation eases



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<https://www.mckinsey.com>: Apparel manufacturers in Asia are facing significant challenges with the current economic environment and drop in global demand—however, solutions for the near and long term are to hand.

The apparel industry rebounded after the COVID-19 pandemic in 2021, with 18 months of robust growth from early 2021 through to mid-2022. However, the second half of 2022 saw a drop in sales across Europe and the United States, providing early indications of a slowdown in the upstream value chain.

The drop in sales was largely driven by rising inflation across the regions (Europe ended 2022 with around a 10% annual inflation; the United States, about 8%) and depressed customer sentiment. As these regions contribute over 50% of global apparel demand, they have a significant effect on the industry—unfortunately, the end of this trend is not yet in sight and is likely to continue through 2023.

The downturn in the fashion market has had a detrimental effect on apparel manufacturers in Asia. Seven countries in the region—Bangladesh, China, India, Indonesia, Malaysia, Sri Lanka, and Vietnam—drive global apparel exports and, as such, the top apparel manufacturers in these countries have been affected by the reduced volumes from Europe and the United States. As a result, major manufacturing units across Bangladesh, India, and Sri Lanka have been forced to run at 60 to 70% utilization and to accept orders at near-zero margins to keep production lines running. And, in a first-of-a-kind event, most of the manufacturing units in both Sri Lanka and Vietnam were shut or operated at minimal capacity during their 2023 New Years in April and February, respectively. The resultant downturn in the industry has led to profit margins for apparel manufacturers in the Asian region shrinking significantly.

In this article, we consider the challenges apparel manufacturers in Asia face in this time of uncertainty and then offer five key shifts—three in the short term and two in the medium to long term—that they can adopt to become resilient in the here and now and to stay relevant and competitive in the future.

Source: Daily FT (27 June 2023)



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Key challenges facing apparel manufacturers in Asia

From our research and conversations with apparel manufacturers about the headwinds with which they are confronted in Asia, we have identified five factors that appear to be driving low profitability and volumes.

Reduced margins for fashion brands

Given the hyperinflation in Europe and the United States, big fashion brands have seen a drop in margins of between two to five percentage points in the last year. As a result, there is a smaller margin to distribute to the manufacturers, with no sight of a rebound anytime soon. Given this, apparel manufacturers are facing pricing pressures and risk of consolidation from fashion brands.

Cost pressure

Most manufacturers are facing a double whammy of reduced prices from buyers due to the economic slowdown, and increased cost from suppliers for raw materials and shipping. For example, cotton prices increased 30% from January to May 2022—and cotton alone contributes around 40 to 50% of a manufacturer's raw material cost. Despite cotton prices dropping in the second half of 2022, they are yet to reach the lower levels seen before the pandemic. Similarly, McKinsey's report, *The State of Fashion 2023*, revealed that 37% of fashion brands will prioritize cost improvements over sales growth, with more than 60% of them focusing on renegotiating contracts to tackle inflation.

Source: Daily FT 27th June, 2023



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Speed and flexibility

Supply chain and demand disruptions are increasing the need for flexibility and agility from manufacturers, with many operating according to traditional capacity-planning methods. This has led to some resorting to expensive air freights to meet customer deadlines, further increasing costs. In addition, there is a risk of “nearshoring” for Asian players, where suboptimal delivery compliance can lead to disruptions from Central American, European, and Turkish manufacturers. For example, a number of big European fashion brands recently signaled their intention to move out of China and Southeast Asia because of supply chain risks and sustainability reasons.

Sustainability

Environmental, social, and governance (ESG) is on top of customers’ and end-consumers’ minds, and the regulatory environment is evolving in line with ESG demands. Considering that the apparel industry accounts for 10% of global greenhouse gas emissions, the impact on the industry is particularly severe. In addition, less than 1% of clothing is recycled currently, leading to increasing landfill and pollution. And, as 2030 has been set as the target year for full circularity in the EU market, pressure from regulatory bodies is ever increasing. Given this, apparel manufacturers face stressors across different dimensions including circularity, traceability, and decarbonization.

The need for digitization

Research has revealed that more than 70% of fashion brands’ chief product officers (CPOs) expect supply chain digitization to be a key capability for suppliers. Apparel brands and retailers are seeking solutions for end-to-end process management and supply chain transparency that will be aided by digitization. The increased focus on cost for fashion brands is likely to lead them to consolidate vendors based on the ability to digitize—thereby creating the risk that apparel manufacturers potentially might be “taken out.” From the manufacturers’ point of view, digitization is a key lever to improve process and transparency on the demand, as well as supply, side.

Source: Daily FT 27th June, 2023



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Fixing the crisis: Redesign for now and the future

Given these challenges, apparel manufacturers need to focus now on transforming themselves to succeed in the short term and be future-ready and competitive for when the market situation eases. They can benefit immensely from five key shifts in their business models, three of which are for the here and now, and two for the future.

Immediate and short-term interventions

The current economy is tough, but apparel manufacturers can make significant changes immediately to stay resilient in the near-term environment.

Make structural interventions to optimize external spend

Systematic interventions across commercial, demand, and specifications-based initiatives in external spend can unlock 5 to 10% cost benefits for apparel manufacturers. However, they need to take a category-backed view of this, as pain points vary by category. For instance, a Southeast Asian apparel manufacturer partnered with its supplier to modify the design of carton boxes, thereby reducing cost. Similarly, a leading apparel player in the region optimized marker efficiency on the cutting table by combining next-generation marker software with best-in-class marker drawing practices.

Further, manufacturers could take a holistic view when attempting to optimize spend across categories. This could include partnering with customers to offer design and optimization ideas (across hangers, elastics, threads, etcetera), creating a win-win proposition.

Future-proof manufacturing

While most manufacturing units may be operating at lower than 100% utilization currently, the time is ripe to prioritize needle-moving initiatives that leverage digital, analytics, and process excellence to drive productivity and strategic benefits with core customers. Consider, for example, a leading Asian manufacturer that digitized critical parts of its processes, professionalized data management, and improved manufacturing efficiency by advanced analytics-driven planning and team-member allocation—thereby improving throughput.

Source: Daily FT 27th June, 2023



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Rethink commercial strategy, including customer and product portfolios

Understanding where to invest globally has never been easy, but rising geopolitical uncertainty and uneven post-COVID-19-pandemic economic recoveries (among other factors) make it even more challenging in 2023. Volatility in the global economy means that manufacturers need to plan more carefully than ever before how to navigate these fragile times.

The fashion brands' arena is in an increasingly polarizing state—while some brands have shown little or negative movement, the top 20 players based on economic profit remained more or less the same from 2019 to 2021 (Exhibit 1). Looking at growth in 2023 and ahead, apparel manufacturers need to carefully re-evaluate their strategies and ensure that they choose the right set of customers with whom to partner.

Further, now is a good time to re-evaluate growth priorities to diversify customers and invest in targeted geographies for resilience—for example, McKinsey's The State of Fashion 2023 report revealed that 55% of survey respondents believe the Middle East has high growth prospects and that Asia-Pacific is a promising region. Some manufacturers have adopted a "local-for-local" approach, prioritizing and serving local customers in the geographies in which they operate, thereby cutting down on shipping and logistics costs.

Various manufacturing companies are also rethinking their product portfolios to adapt to evolving and selective consumer trends. For example, many consumers in Europe and the United States could be more selective in the third quarter of the 2023 fiscal year and are likely to buy clothes tailored to specific needs, such as sweatshirts and outerwear. Similarly, going forward, research has revealed that gender-fluid fashion, formal wear, and occasion wear are probably going to take on new definitions.

In addition to the above interventions, manufacturers need to make strategic shifts toward higher margin products to be less vulnerable to being replaced by fashion brands when volumes open up.

Medium- and long-term interventions

To ensure they are ready when the markets stabilize, apparel manufacturers in Asia can take various actions to address customer needs and unlock value.

Source: Daily FT 27th June, 2023



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Reconfigure supply chain models to cater to evolving customer challenges

Continued disruptions in supply chains are a catalyst for reconfiguring global production. Some large companies in Southeast Asia have made strategic investments to fundamentally alter the regional cost landscape—for example, vertical integration with fabric mills, in-house laboratory accreditations, and more.

As the majority of fashion brand CPOs expect supply chain digitization to be a key capability for suppliers, companies need to adopt digital and analytics to drive value and improve user experience across the supply chain.

In addition, resilience is one of the key asks from most fashion brands today. A critical success factor is the “spreading out” of manufacturing and supply chain footprints, which to date only a handful of the leading Southeast Asian manufacturers have done. In fact, over 60% of fashion executives believe that “nearshoring” and “strategic partnerships” are the best response to the supply chain crisis (Exhibit 2). Therefore, locating manufacturing units closer to long-term partners and strategically partnering with customers closer to current units might prove beneficial for apparel manufacturers.

Invest in value-backed digital and analytics interventions

Digital and analytics have the potential to unlock additional value well beyond traditional initiatives while boosting user experience. More important, they can release precious managerial time that could instead be used for strategic interventions. For instance, a Southeast Asian apparel company that was facing heavy inflation created a cost-monitoring, spend-intelligence dashboard that automated commodity index analysis and guided category managers with month-on-month target prices. This had a two-fold, beneficial effect. The company was able to make a fundamental shift toward more fact-based and analytical negotiation, thereby creating more value. Second, it helped fast-track the analysis that busy category managers would have spent their time doing before.

The headwinds that face the apparel industry may be strong, however, manufacturers can make strategic shifts to unlock around 5 to 15% value across functions. They can use this time to redesign their approaches—to become resilient in the current market environment and to get into the best competitive state for growth among fashion brands when the markets stabilize.

Achim Berg is a senior partner in McKinsey’s Frankfurt office; Vidhya Ganesan and Ganaka Herath are partners in the Colombo office; Julian Hügl is an associate partner in the Stuttgart office; and Praveen Krishnan is an associate partner in the Bengaluru office.



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Sri Lanka's Garment Exports Ease 17% To \$1,769.9 Mn In Jan-Apr 2023



INSIGHTS

In January-April 2023, Sri Lanka's garment exports fell 17 per cent to \$1,468.7 million. Meanwhile, textile exports slightly increased by 1.8 per cent to \$114.2 million. Combined, textiles and garment exports accounted for 53.25 per cent of all its industrial exports.

However, overall textile and clothing imports declined significantly during this period. Sri Lanka's garment exports stood at \$1,468.7 million during January-April 2023, which decreased 17 per cent over the exports of \$1,769.9 million in the same period of the previous year, as per statistics released by the Central Bank of Sri Lanka. The country's garment exports dropped by 24.1 per cent in April 2023 due to the world economic slowdown.

During the first four months of 2023, textile exports from the island nation increased by 1.8 per cent year-on-year to \$114.2 million. The exports of other made-up textile articles stood at \$33.8 million during the same period, down 20.7 per cent, according to the bank's report titled 'External Sector Performance'.

Textiles, garment, and other made-up textile articles' exports together accounted for 53.25 per cent of all industrial exports from Sri Lanka during the period under review, the report showed. The exports of all textile products totaled \$1,616.7 million in January-April 2023, while Sri Lanka's total industrial exports stood at \$3,035.6 million in the four months of the current year.

In April 2023, all textile products exports from the nation declined by 23.2 per cent year-on-year to reach \$343.8 million. Category-wise, garment exports decreased by 24.1 per cent to \$310.8 million, while textile exports eased 10.3 per cent to \$25.3 million. The exports of other made-up textile articles were down by 24.2 per cent to \$7.7 million. On the other hand, imports of textiles and textile articles eased 32.2 per cent to \$787.2 million, while clothing and accessories imports were down by 38.8 per cent to \$57.5 million during January-April 2023.

Source: Fibre2Fashion



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EXPORT OF APPAREL STATISTICS

Export of Apparel for the Month of May 2018 - 2023

	2018 US\$. Mn	2019 US\$. Mn	2020 US\$. Mn	2021 US\$. Mn	2022 US\$. Mn	2023 US\$. Mn	2022/2023 Change %
Total Exports	376.00	400.00	204.78	344.12	446.42	383.17	-14.17
US	153.00	160.00	99.02	136.05	191.74	147.30	-23.18
EU	105.35	117.87	54.23	103.93	129.33	123.03	-4.87
UK	65.50	69.11	28.71	54.32	61.59	50.18	-18.53
Other	52.15	53.02	22.82	49.82	63.76	62.66	-1.73

Export of Apparel January - May (Cumulative) 2018 - 2023

	2018 US\$. Mn	2019 US\$. Mn	2020 US\$. Mn	2021 US\$. Mn	2022 US\$. Mn	2023 US\$. Mn	2022/2023 Change %
Total Exports	1,968.00	2,139.00	1,452.88	1,941.66	2,255.99	1,884.13	-16.48
US	867.00	934.00	651.03	789.64	966.53	746.45	-22.77
EU	506.70	560.30	377.75	596.26	650.48	557.15	-14.35
UK	335.33	344.97	222.27	267.57	310.97	263.79	-15.17
Other	258.97	299.73	201.83	288.19	328.01	316.74	-3.44

Export of Apparel in the Month of May 2018 - 2023 to All Countries

	2018 US\$. Mn	2019 US\$. Mn	2020 US\$. Mn	2021 US\$. Mn	2022 US\$. Mn	2023 US\$. Mn
Chapter 61	205.00	225.00	116.26	215.60	268.04	224.31
Chapter 62	163.00	166.00	72.79	119.24	168.65	150.28
Chapter 63	8.00	9.00	15.73	9.28	9.73	8.58
Total	376.00	400.00	204.78	344.12	446.42	383.17



European Parliament brings us one step closer to corporate accountability but key improvements are still needed

Clean Clothes Campaign, welcomes the European Parliament's report on Corporate Sustainability Due Diligence Directive (CSDDD) approved today with a broad cross-political majority. This vote marks an important step towards due diligence obligations for companies and corporate accountability.

One month ago we [commemorated](#) the 10th anniversary of the Rana Plaza building collapse in Bangladesh which killed at least 1,138 workers and left thousands more injured. This gruesome tragedy devastated the lives of thousands of workers and their families. It brought worldwide attention to rampant exploitation in the garment industry and the need for corporate accountability. Despite promises for changes, the voluntary commitments made by companies were not enough to bring significant change to the lives of garment workers.

Over the last years, workers, citizens, and civil society worldwide called for ambitious laws that would protect workers, communities and the environment worldwide and hold companies accountable for the negative impact of their business.

The text approved today shows the EU Parliament's determination to fight for the respect of human rights and the environment worldwide. Members of the European Parliament improved the initial EU Commission's proposal and subsequent Council General Approach on several elements.

The text now requires an increased number of companies to carry out due diligence throughout their value chain and on all their business relationships, in accordance with UN and OECD international standards. Companies would have to pay attention to a wider range of human and labour rights, including the ILO Conventions on Occupational Safety and Health and on Violence and Harassment in the World of Work, as well as the right to a living wage. Companies would be asked to assess how their business models and pricing practices can cause harm, thus acknowledging the role of unfair purchasing practices in many violations. Victims of corporate abuses will also find that some of the procedural hurdles they face when seeking justice will be lifted.

Source: CleanClothesCampaign



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We regret however that the Parliament stopped short from embedding value chain mapping and transparency as part of the due diligence obligation. A comprehensive risk-identification process should include mapping and disclosure of individual suppliers. Moreover, despite countless [reports](#) on the failures of social auditing and verification initiatives in ensuring respect for human rights, the Parliament's report still gives too much importance to such initiatives. Grievance mechanisms should have been further made an integral part of remediation. We are also concerned with the remaining limitations on civil liability including the absence of reversal of burden of proof in favour of those suffering from business-induced violations.

As million of garment workers across the world see their rights for freedom of association, occupational health and safety and living wages attacked every day, it is high time for the EU to bring change to the way business is done.

Following this vote, the negotiations between the three EU institutions will start shortly. We call on the co-legislators to follow the lead of the EU Parliament and incorporate those key improvements in the final version of the legislative text.

Source: CleanClothesCampaign