Chapter 1

Phasing Out of MFA and the Emerging Trends in the Ready Made Garment Industry in Sri Lanka

W.M.Tilakaratne

Introduction

Textile and clothing industry in Sri Lanka had a modest beginning in the 1960's producing mainly for the domestic market under heavy protection. The export-oriented production of clothing (ready made garments) began in the 1970s and expanded rapidly after 1977 with the introduction of trade liberalization measures and a variety of market oriented economic policy reforms. These reforms aimed at promoting industries producing goods for the export market than for the domestic market. The incentive structure provided by the government included subsidies and duty rebate schemes, lower corporate taxes, tax holidays and duty free imports of machinery and raw material. The establishment of free trade zones around Colombo, closer to the airport and the harbor with necessary infrastructure facilities as well as the provision of government support in the form of institutional facilities such as the Foreign Investment Advisory Council (later Board of Investment – BOI) and banking facilities were the other measures taken to promote industrialization. Several free trade zone areas were later established in other parts of the country.

Foreign direct investment played a very important role in the early period of its establishment and growth, though in later years domestic capital became equally important. The Multi Fibre Agreement (MFA) introduced quota system provided an assured market in USA, EU and Canada for countries like Sri Lanka. This attracted many garment manufacturers from East Asian countries such as Korea, Taiwan and Hong Kong whose quota in these markets had already been exhausted. The unutilized quotas that were available in Sri Lanka were an encouraging factor. Some western countries also moved their operations because of the high cost of production in their own countries. Apart from the incentives and the unutilized Sri Lanka's export quotas to USA and European countries, there were other advantages such as low wages and relatively educated and trainable labor force. Many Sri Lankan investors entered the industry and as a result the number of locally owned establishments increased. A recent survey conducted by the

Ministry of Industries (2004) provides the following distribution of ownership: 100 percent Sri Lankan ownership 74%; 100 percent foreign ownership 13 %, and joint ownership 10%.

1. The Current Status of the Garment Industry in the Economy

The growth of Sri Lankan garment industry as a manufacturing sub-sector has been remarkable in terms of its contribution to GDP, exports, foreign exchange earnings and employment generation. In 2002 its contribution to GDP reached 6 percent and to that of industrial production over 39%. By the late 1980s it had overtaken the other traditional exports (tea, rubber) as the single most important export item. For example, the share of tea which was the main export accounting for 48.5 % of total exports in 1978 had come down to 26 % in 1990 and that of garments increased from 3.6 % to 32.8 during the same period. Similarly, it provided employment to 6 % of the labor force and accounted for 33% of the manufacturing employment.

Accurate data on the exact number of garment factories is not available due to unrecorded closing down of factories and different criteria and methods adopted by various government and other agencies when recording data pertaining to garment factories. The establishment of factories began to accelerate after 1992 with the 200 Garment factory programmed which aimed at taking industry to rural areas in order to reduce unemployment. More quotas were given to those rural based industrialists in addition to the other facilities mentioned above. By the end of 1996 there were 154 garment factories in rural areas employing 76,821 workers (Kelegama & Epaarachchi, 2002: 199). According to available data, the number of garment factories has increased from 5 (with an export value of US$ 15.2 million) in 1977 to 891 in 1999. The Ministry of Enterprise Development and Industrial Policy gives a figure of 1061 for the year 2001 (Kelegama & Wijayasiri, 2004: 18). Out of the 891 factories, 417 had received BOI status, which entitles an enterprise to duty free imports of inputs, off-shore borrowing and many other facilities. A survey conducted in 2004, by the Department of Labor and Oxfam Sri Lanka, recorded that the total number of factories employing 50 or more workers were about 745 indicating considerable reduction. Out of the 745 establishments, the total number coming under the purview of BOI was 460. The remaining was under the Ministry of Industries or the relevant Provincial Council. No accurate data is available on the number of factories that

was closed down. According to a News paper report in 2002, 150 factories that were in operation had been closed down (Kelegama, 2004:7).

2. Geographical Distribution

The geographical distribution of the garment factories indicates a heavy concentration within the Western Province and this is largely due to the better infrastructure facilities such as, roads, communications, airport and harbor and other services available in Colombo city and within the region. In 1999 over 72 % of the garment establishments were in the western province providing employment to 65 % (i.e. 181,329)   of the total workforce in the garment sector. The other provinces had the following distribution: Southern 6%; Central 6 %; North Western 7 %; North Central 2 %, Uva 2%; Sabaragamuwa 4 % and Eastern 1 %. The concentration of industries in the western province has created several problems including scarcity of labor, road congestion, environmental pollution and population congestion (Department of Labor & Oxfam, 2004).

3. Employment

The industry became a source of income for many poor households in rural areas. Many workers came from distant areas to the Western province where most of these factories were located. At present the garment sector provides direct employment to about 310,500 workers and over 51 % of them are employed in large factories while the remaining 33% in medium and 16% in small factories (Kelegama & Wijayasiri, 2004: 19). A very high proportion (87 %) of the workforce in the garment industry is females and over 60% of them are in the age group 18-25 (Department of Labor and Oxfam, 2004).   A recent survey of 14 factories completed by the authors also indicates a proportion of 83 % females in the total workforce. These females tend to work for short periods of about five years and rarely one could find women who have worked for more than 10 years. It is also evident that many of them hold non managerial and non technical jobs such as machine operators, checkers, helpers, line leaders, ironers and supervisors. Male dominance is most evident in the senior and middle level management grades (84% and 64 % respectively) (Kelegama & Epaarachchi, 2002:201).

4. Size Distribution of Factories

A large proportion of the garment factories are small and medium scale. The breakdown of manufacturing units according to value of their exports indicates that over 64% of them can be classified as small while another 14 % as medium and 22% as large scale (See table 1). However, the small and medium scale industries export only about 15 % of the total value of exports. This illustrates the dominance of a few large firms within the industry that can claim to about 85 % of the total exports.

Table 1- Breakdown of Manufacturing Units
(Classified according to the value of exports)

Category	Range (Rs. Mn)	No. of exporters		Export Value (Rs. Mn)	
Small	0. 25Mn. -100Mn.	549	64 %	10,335	5 %
Medium	101Mn.-250Mn.	124	14 %	20,476	10 %
Large	251Mn. & Over	186	22 %	177,822	85 %
Total		859	100 %	208,633	100 %

Source: Sri Lanka Garment Journal –Volume 2/ 2001 (As quoted by the Sri Lanka Apparel Industry Five Year Strategy - Final Report 2002)

Another classification of the size distribution of firms based on the total number of employees indicate that 32 % as small (less than 100 workers) and 50 % as medium size (101-500 workers) units, while only 18 % in the large category (over 501) (Kelegama & Epaarachchi, 2001: 199). A survey conducted by the Ministry of Labor and Oxfam (2004) based on the above classification gives the following size distribution: small 20%, medium 53 %, and large 28 %. It appears that these few large factories provide the highest proportion of employment (60 %) to the workforce in garment industry, while the remaining 40% are employed in small and medium size factories.

5. Contribution to Export Income

In 1992 the garment industry became the largest foreign exchange earner and by 2000 the share of garments in total merchandized exports reached over 50%, earning US $2.73 billion. The expansion was exceptionally high during the 1990-1996 period (see table 2). The exports of garments came down (US $2.33

billion) during the 1997-98 period following the East Asian financial crisis and again in 2001 due to the recession in USA and EU and the terrorist attacks on Sri Lanka's main airport and the subsequent uncertainty that prevailed in the country. There has been a gradual recovery from 2003 onwards. By the year 2004 the textile and garments accounted for 49 % of the total exports and 62 % of the total industrial exports. According to the data provided by the garments exporters association the value of garment exports has increased to US $ 2.68 billion in 2004 and the monthly export figures available for the period from January to August 2005 indicate an upward trend.

The impressive growth can be seen both in the terms of the volume and value of garment exports until about year 2000. This is most evident in the value index which has increased from 100 in 1990 to 477 in 2000, as compared with an increase from 100 to 341 in the volume index during the same period, indicating a gradual shift in production towards high value items. However, despite the remarkable growth in exports earnings Sri Lanka's share in world garment exports is still insignificant.

Table -2 Export Performance of Textile and Garment Industry in Sri Lanka: Key Indicators

	Export Value (US$ million)			Export Indices 1990 =100			T & G as percentage of		Sri Lanka's share in world garment exports (%)
	Textile (T)	Garments (G)	T & G	Volume	Unit value	Value	Total merchandized exports	Total Foreign Exchange	
1978	0.3	30.4	30.6				3.6	-	
1980	0.8	109.4	109.7				10.3	-	0.30
1985	4.7	283.5	288.3				2.6	-	0.63
1990	2.4	606.3	608.7	100	100	100	30.7	20.9	0.60
1995	43.2	1465.5	1852	226	130	295	48.7	32.8	1.00
2000	271.5	2723.1	2994.6	341	140	477	54.0	38.5	1.33
2003	175.3	2400.0	2575.3	313	131	410	50.2	31.3	-

Source: Premachandra Athukorala , 2005, (unpublished paper.) Compiled from Central Bank of Sri Lanka: Annual Reports and UN Comtrade database (for world export data)

6. Markets

The main export market for Sri Lanka's garments has been the USA and it continues to be the most important one. In 2004 the US market accounted for 58 % of the total garments exports. The second most important is the EU market with 37% while all other countries have a smaller share of 5 % (Central Bank of Sri Lanka, Annual Report 2004). The other importers accounting for the remaining 5 % of garments exports are Canada, Switzerland, Australia, Japan and South Korea. Among the EU countries, the United Kingdom buys over 50 % of the exports and the shares of other countries EU are: Germany 17%, Belgium 7%, France 6% Netherlands 7% and Italy (3%). Bilateral agreements Sri Lanka had signed with USA and EU, Canada and few other countries over the last two decades helped to maintain an assured market for Sri Lankan exports of garments for some time until the MFA phase out. Although the Indo-Sri Lanka Free Trade Agreement came into operation in 2000, had agreed to export 8 million pieces of garments to Indian market, the implementation of this has been delayed for variety of reasons (Kelegama & Epaarachchi 2002).

A very high proportion (90 %) of Sri Lankan garments under the quota system had been standard casual wear with low value added aimed for the major markets. However, during the last two decades the industry was able to establish a strong international customer base. The higher value added garments have mostly been non quota products sold in the niche markets with designer labels such as Victoria's secrets, Pierre Cardin, Triumph International, Marks and Spencer, British Home stores, C & A etc (Kelegama & Epaarachchi, 2002). The top ten buyers are Gap, May Department, Nike, Columbia, Sportswear, Wall Mart, Next, Marks & Spencer, Tommy Hilfinger, Kellwood and Reebok (Department of Labor & Oxfam, 2004). The Colombo based buying offices act as agents for many of these buyers and over 65 % of Sri Lanka's garment exports are channeled through these offices (Kelegama & Wijayasiri, 2004: 21).

7. Phasing out of MFA and Major Issues facing the Garment Industry in Sri Lanka

The gradual phasing out of the Multi Fibre Arrangement (MFA) and the reduction of restrictions on textiles and garments over a period of 10 years under the WTO jurisdiction was completed with the final phasing out of quotas on 1st of January

2005. For some countries such as China and India it was predicted that the removal of these quotas would improve their competitive positions, while those that had guaranteed markets mainly due to quotas were expected to face some difficulties in keeping their market share. It was envisaged that for Sri Lanka the free market system during the post MFA period would pose severe challenges for the garment industry exposing it to intense international competition (see World Bank and ADB, 2005, Saman Kelegama, 2004, Kelegama & Epaarachchi, 2002, Joint Apparel Association Forum, 2002). In addition the USA has signed agreements and given special concessions to Mexico and some Caribbean and African countries which have caused loss of some markets for Sri Lanka.

There has been several view points expressed long before the end of 2004 regarding the post- MFA trends in Sri Lankan garment industry. In a recent study Kelegama (2005) has succinctly summarized these view points. The rather optimistic view point is based on the predicted rapid expansion in the world trade in garments. Accordingly the world garment exports would increase from US $196 billion in 2000 to US $ 350 billion in 2005. Some of the well established large Sri Lanka firms constituting about 12 percent of the total firms control nearly 72 percent of Sri Lankan garments exports and have strong market contacts. They will be able to take advantage of this expansion and compete in a quota free trade regime. Although some weak factories may be closed down due to competition the dominant firms can acquire some of them or use them for sub-contracting of production.

The pessimistic viewpoint, on the other hand, is based on the argument that Sri Lankan firms are not competitive enough, do not have adequate forward and backward integration and will not be able to compete with varieties of garment exports from China and India. Low productivity and high cost of production are the main factors contributing to low competitiveness. It is argued that the value added in Sri Lankan garments is about 30-40 percent due to heavy reliance on imported fabric and other material. Similarly most garments exporters rely on intermediaries –buying offices – for their exports and have no direct contact with buyers. Countries such as China, India and Pakistan have well established clothing industries supporting the garments sector, whereas the Sri Lankan firms depend mostly on imported fabric and other accessories. China will be able increase its share of world trade in garments to nearly 50 % by the year 2010 while the share controlled by the other Asian countries will shrink to about 20 %.

In this process Sri Lanka will not be able to gain much from the competition within this shrinking market share.

The above negative view of the future scenario appears to be too pessimistic as the emerging trends within the industry in recent years tend to indicate. However, it may also not be highly optimistic as suggested by those supporting the first view point. In order to assess the current trends and developments within the industry we need to examine the various aspects pertaining to structural changes, productivity, labor related issues, technological aspects and market trends affecting the industry. The analysis in the remaining part of this section will be based on the information collected from 14 factories surveyed by the authors (see Annex- 1) as well as on various studies carried out by other organizations on garment industry in Sri Lanka.

Sri Lanka's dependence on quotas declined even before the final phasing out of MFA in January, 2005 and the industry was already entering into a non quota market especially in the EU countries. The leading manufacturers took serious note of the possible threats in future. In 2002, the Joint Apparel Association Forum (JAAF) prepared a 'Five Year Strategy for the Sri Lanka Apparel Industry' taking into account various strengths, weaknesses, opportunities and threats (SWOT analysis) in the garment industry. The objective of the strategy was to consolidate and strengthen the Sri Lankan apparel industry to ensure its success beyond the year 2005. Many challenges were identified and the necessary action plans for implementation have been proposed. The main challenges are given below.

    (a)   The heavy concentration of Sri Lanka's export markets in USA and EU and this heavy dependence carries a business risk and therefore need diversification of market destinations.

    (b)   The global development in trade blocks and regional preferential trade agreements (such as the USA trade agreements with Mexico, Caribbean and some Sub-Saharan African countries) can be an additional threat. Therefore the need to lobby developed countries for equal status was highlighted.

    (c)   Sri Lankan garment industry is not competitive enough mainly due to low labor productivity and insufficient technological advances. Labor productivity rates in Sri Lanka has been around 35-45 % as compared with rates of 65-75 % in competitive countries such has China. Thus in terms of prices Sri Lanka will be in a disadvantage position.

(d) Being geographically far from the main markets (USA and EU) and the absence of a raw material base contribute to longer lead time. Sri Lanka's lead time in manufacturing is around 90 days as compared with 30-60 days in countries closer to the main markets (eg. Mexico, East European countries and China). In a competitive market the reduction of lead time is most important.

(e) Sri Lanka's raw material base requires further development as the country depends heavily on imported raw material and accessories. Therefore development of fabric mills, washing plants and printing and heat –sealing plants will move the industry towards providing a total service to its buyers.

(f) Sri Lankan apparel industry lacks own brands and should aim at promoting own brands internationally.

(g) Sri Lankan firms need to develop marketing competencies in expanding new markets and strengthening exiting ones. This requires product development and manufacturing and technical know-how.

(h) Industry should be able to deliver the fast changing basic customer requirements in terms competitive prices, quality and speed. This would require provision of a total service comprising raw material base, superior product development, efficient manufacturing capability, and providing the buyer with assistance in the way of marketing and design know-how.

Based on the above analysis the document also identified several strategic objectives in order to survive beyond 2005. Among these the most important were:

(a) Increasing the industry's turnover from US$ 2.33billion in 2001 to US $ 4.5 billion in 2007. For this purpose the industry should grow at an annual rate of 12 %.

(b) Transform the industry from a 'manufacturer' to provider of a 'fully integrated service.' as described above.

(c) Increase market penetration to the premium market segments. This requires transforming from basic products to superior branded products. The current lower end of the market is highly competitive and supplied by producers from Vietnam and Bangladesh where the cost of labor is very low. Therefore Sri Lanka should move up the value chain by supplying more value added high fashion garments. In this regard the proportion of garments sold to specialty stores be increased from 10% to 20% and those sold to Department stores from 50% to over 60%.

(d) Become internationally famous as a superior manufacturer in specific product categories.

(e) Consolidate and strengthen the industry to meet the challenges of the quota free era.

Although there has been some success in the achieving few of the above objectives, on the whole, most targets appear to be too optimistic. The value of garment exports achieved after 2001 has been well below the target and the annual growth rates in exports had been in the range of 2 -5 % (except a 9 % growth rate achieved in 2004) much lower than the targeted 12 % . The estimated annual turnover for the year 2005 has been around US $ 2.8 billion. At a recently held annual general meeting of the JAAF, it was decided to review and revise the original five year strategic plan (Daily Mirror, Financial Times News Paper, and December 22, 2005).

8. Market Links and Labor Compliance

Over the years, large and some medium manufacturers in Sri Lanka have established strong marketing links with buyers and have entered the branded and high value clothing markets. Establishing an image as a quality garment producer is a strength of the industry, but more has to be done in order to improve the quality and reach the upper market segments so as to target a high profit margin of 15 -20 %. The labor standards and factory conditions in Sri Lanka have been improved considerably and the high compliance with international labor and environmental standards has helped the industry. This was also one of the facts revealed during the survey of 14 factories. Most buyers insist on ethical requirements and welfare facilities for workers in addition to other demands (see table–3). Substantial proportion of the factories surveyed has provided basic welfare facilities in addition to meeting other legal requirements governing the employment of workers (table-4). Factories that provide better facilities to workers have also indicated that these measures have contributed to the improvement of efficiency and reduction of absenteeism among workers.

Table 3-What Agents / Buyers Insist On

	No of factories
Competitive prices	14
Quality improvements	13
Meeting deadlines	14
Ethical requirements (compliance)	12
Welfare	13

Table 4-Facilities Provided to Employees by the Factory

Facility	No. of Factories
1) Restaurant	9
2) Free/subsidized meals	13
3) Free/subsidized Transport	9
4) Hostel/accommodation	2
5) Medical facilities	12
6) Recreation	7
7) Other	10

These standards are superior to those of the other competitors such as India, Bangladesh and China (World Bank & ADB 2005:41) and have created a good name among buyers and consumers in the western countries. The Sri Lankan garment industry has been praised for its record in labor compliance and in recognition of this the EU granted Generalized Special Preference (GSP) concessions (20 percent duty reduction on GSP) in 2003. Sri Lanka could perhaps be the only country to receive GSP concessions on the basis of compliance (Kelegama & Wijayasiri, 2004: 21).

Sri Lanka's educated and trainable labor as well as the absence of trade unions confronting management within the garment industry has been positive factors that contributed to its rapid growth. Yet, the industry still suffers from a variety of problems affecting its international competitiveness. Some of these problems as identified by the management of the factories surveyed are listed below and discussed in the following sections.

Table -5 Problems Identified by the Firm
(Multiple answers)

Main problem	No of Factories Reporting
Inadequate infrastructure	8
Labor problems	11
Short of capital/finance	8
Lack of skilled labor	10
Lack of state support	9
Markets for the products	2

(a) Labor Related Issues

As can be seen from the table -5 a major issue confronting the industry relates to labor. Absenteeism, high turnover, shortage of labor and inadequate training are listed as major issues of labor faced by the industry (table -6). All these labor related issues reduce efficiency and affect productivity. The high turnover and absenteeism have been reported by all factories. There are many factors that have contributed to high turnover rates. Since most workers are young females in the age group of 18-25, many of them leave employment at marriage and only a few would want to continue after marriage. The other reasons compelling them to leave are numerous. As revealed by the management and workers themselves they are, family related problems, the monotonous and hard working environment within factories and the social stigma created in the early stages of establishing garment industries. The turnover rates have been between 5-10% per month varying according to the wage structures, other facilities and benefits available within each firm. High rates of absenteeism (monthly rates between 4-7%) is common to most factories in Sri Lanka in spite various attendance bonus schemes introduced by most factories. The causes are numerous, but they are mostly related to hard work in factories, attending social functions, family emergencies and seasonal demand for family labor for farm work in rural areas.

Table -6 Labor Related Problems (multiple answers)

Absenteeism	14
Lack of interest	6
Indiscipline	3
Inadequate training	8
Not willing to work over time	1
Shortage of labor	9
Labor leaving company	14

In spite of the high female unemployment in rural areas (over 12%) the difficulty of replacing the vacancies created by those leaving has become a major problem due to shortage of trained labor. Only those factories with better wages and other facilities could find such skilled labor. Many other factories have to recruit unskilled labor and provide training within factory. Except for a few many did not have special training centers belonging to the factory. This highlights the need to establish more training schools than available at present and providing financial assistance to firms to establish their own centers.

(b) High Cost of Production

Despite Sri Lankan labor being categorized as educated and trainable, variety of other factors have affected their productivity and international competitiveness of the garment industry. These factors are relatively low productivity, insufficient technological changes, relatively high labor costs as compared to those in other South Asia, and Vietnam, absence of domestic raw material base and high cost of basic facilities such as electricity and water. The hourly wage rate in Sri Lanka is US $ 0.50 which is higher than those of the competing countries such as Vietnam, Bangladesh, and Pakistan (US $ $0.40) and Indonesia (US $0.30). The competing countries such as China, Thailand and Malaysia have wage rates of US$ 0.70, $ 1.2, and $ 1.1 respectively (Kelegama & Wijayasiri, 2004:29). This relatively high labor costs of Sri Lankan labor when coupled with high turnover, absenteeism, more public holidays and inadequate modern technology in some factories, invariably lead to poor labor productivity in the industry.

Although China has slightly higher wage rate, the investment climate appears to favor the Chinese garments firms. According to a study done by the ADB and the World Bank, the value added per worker in the Sri Lanka garment firms is 28 % lower than that of a Chinese worker. Chinese firms operate with higher level of capital per worker than the Sri Lankan firms (Sri Lankan firms 30 % less than Chinese) and this has contributed to their higher value added (ADB , World Bank, 2005: 41-42).

While labor is only a smaller component (15-20 %) of the unit cost of production, there are other factors that have contributed to low productivity in Sri Lankan firms. The high utility charges such as electricity, water, telecommunications freight and insurance have contributed to higher production costs. Electricity charges are considerably higher in Sri Lanka than in other countries such as

Bangladesh, India and Indonesia. In Bangladesh it is 37 % cheaper and while in India it is 71.6 % cheaper than Sri Lanka.

The other investment climate indicators also favor Chinese firms. The power supply is more expensive and unreliable in Sri Lanka and this has compelled many firms to have own power generators, thereby adding to the high cost of production. For example, 76 % of the Sri Lankan firms depend on such power generators as compared with 27 % in China. Sri Lankan firms have to depend more on imported fabric and therefore hold high inventories (30 days), whereas the Chinese counterparts do not hold high inventories (10 days) as they get the supplies of raw material within the country. (ADB & World Bank, 2005:42). This has also contributed to longer lead times among Sri Lankan firms.

(c) Lack of Raw material Base

As outlined above, the Sri Lankan garment industry is heavily dependent on imported fabric and other accessories and this has contributed to weakening of its international competitiveness as against countries such as China, India, and Pakistan that have own textile industries. In these countries the components within garment industry are vertically integrated from raw material (cotton, silk, wool and man made fibers) production to spinning, weaving, knitting and finished fabric products and finally garments. Availability of a strong supply chain considerably improves their competitiveness in the world market.

In 2001, over 80 % of fabric requirements and 70 % of other accessories of Sri Lankan garment industry were imported and this may have come down slightly in recent years with the expansion of the domestic capacity in textile and accessory production. The backward integration system in the supply chain is highly inadequate. In 2004, import of textile comprises over 57 % of the total value of garment exports (Table -7). Value addition in garment industry is low as the cost of fabric amounts to 65-70 percent of the finished product.   Most manufacturers depend on the designs provided by the buyers and also have to buy their fabrics from the recommended suppliers abroad. According to our survey, out the 14 factories all said they produce according to the specifications given by the buyer. Out this 6 had bought all their input requirements from recommended suppliers, and another 7 bought some proportion it from them while only one manufacturer had bought all from his own supplier. Only a very limited number of

manufacturers in Sri Lanka have design and product development capability and they are in a position to generate higher value addition.

Table- 7 Values of Imports of Cotton Yarn and Textile

Year	Value in US Dollars (Million)				
	2000	2001	2002	2003	2004
	1421	1320	1321	1372	1514

Source: Central Bank of Sri Lanka: Annual Reports.

The non availability of well developed raw material base and the absence of product development and design capability negatively affect international competitiveness in a world of rapidly changing styles and fashions. This is most relevant with regard to meeting deadlines, quality improvements and offering competitive prices which are often insisted on, by agents and buyers as revealed from our own survey (table -3). Thus reducing lead time and meeting some of these requirements of the buyers are very important. Those countries with developed material base (Hong Kong, China, India, Mexico) in addition to being located closer to the markets have shorter lead times of less than 60 days. Sri Lankan firms being located far away from major markets have to spend more time not only to import raw material but also to ship the products to their market destinations in the west. Thus their lead time ranges between 90-120 days.

(d) Other Major Issues

A noticeable feature of Sri Lankan garments exports is that they are highly concentrated into few categories. Majority of the products using low technology are low to medium priced casual wear for men and women. The profit margins in these products are low and subject to severe competition from other Asian countries capable of producing similar products at a lower cost. During the survey it was revealed that 8 out of 14 firms had to reduce their product prices by about 10-20 % in order to remain in market. Diversification into high value products with improved technology is necessary not only to survive in the post MFA era, but also to earn a higher profit margin. Some manufacturers have been able to establish strong links with well known international buyers and department stores in the USA and EU. The 14 firms surveyed by the authors have revealed signs of moving in this direction (se tables 8 to 10 below and also tables 25-30 in Appendix)

Table 8- How Firms Respond to Demands of the Buyers
(Multiple answers):

Responses	No of Factories (N=14)
Update technology (new machinery)	5
Plan to meet deadlines	3
Bear the cost (deadlines cannot be met)	1
Design accordingly	5
Improve productivity	1

Table 9-Changes Introduced by Management
(Multiple answers)

	No. of Factories (N=14)
New Machinery	12
Improve labor productivity	3
Air conditioning	2
Develop New Designs	2
Improve quality	2

Table -10 If those Helped Improve Productivity

Yes	12
No answer	2

9. Market Trends

Sri Lankan garment exports are still concentrated into a few leading markets, such as USA and EU. It has not been able to penetrate much into other big markets such as Japan and Canada. However over the years the government has made some efforts to diversify the markets particularly in the EU countries.

Table- 11 Export Destinations of Sri Lanka's Garments – (Share in total %)

	2000	2002	2003	2004
EU	33	31	33	37
USA	62	63	61	58
Other	05	06	06	05

A comparison of the relative position of Sri Lanka's export performance in the two main markets (USA & UK) over the last few years covering the pre and post

MFA periods reveals some interesting patterns. Table -12 presents the export trends of some selected countries in the US apparel market. The post MFA period compares the export performance for the period January to September in 2005 with the same period in 2004. As can be seen from the table, while the total export to USA has expanded since 2000, much of this increase has been taken by countries like China, Cambodia, India and Pakistan. By contrast Sri Lanka's volume of exports has come down during post MFA period (-2.9) but the country gained in terms of value both before and after 2004. It is clear that Sri Lanka is facing severe competition in the US market and it has managed to survive by way of moving into high value exports. Sri Lanka's share in the US market in terms of value has come down from 2.46 % in 2000 to 2.28 % in 2003 but slightly improved to 2.32 % in 2005. The shares of the other countries have increased over the years. This is most evident in the case of China whose share increased from 10.48 % in 2000 to 16.1 % in 2004 and to 25% in 2005. An interesting feature contributing to the slightly improved export value of Sri Lanka during the post MFA period is the rise in the average unit price of these exports. It had improved by 11.55%, while for the other countries, except India, the increase was relatively low. This is a good indicator that Sri Lankan manufacturers are now concentrating more on high end of the market (Prasanna & Gowthaman, 2005). In UK, the second largest market for Sri Lanka, its performance improved during the period 2000-2004 period, but became weaker after the MFA both in term of volume and value. China, India and Vietnam are expanding their market shares in UK. However as in US market, Sri Lanka's average unit price in UK too has improved after the MFA.

Table 12-Percentage Change in Imports of Apparel to the US Market from Selected countries

Country	% Change in terms of Volume		% Change in terms of Value	
	2000 -2004	Jan –Sept. (2004-2005)	2000-2004	Jan-Sep (2004-2005)
Sri Lanka	8.20	-2.9	6.63	11.23
Bangladesh	7.59	20.79	-3.52	21.08
Cambodia	60.08	22.39	77.18	17.47
China	136.62	64.76	72.52	68.49
India	31.73	5.91	22.24	33.70
Pakistan	32.74	3.89	23.57	9.59
World Total	21.90	5.97	12.98	7.85

Source: United States Department of Commerce and International Trade Commission (Taken from Prasanna and Gowthaman, 2005).

In 2004 the exports to EU expanded considerably due to a number of agreements signed in recent years. Under the Generalized System of Preferences (GSP), Sri Lanka enjoys a 40 percent duty concession in the EU market for garments and in 2004 Sri Lanka qualified for additional 20 % tariff concession for meeting EU labor standards over and above the earlier 20 % concession that was given. In July 2005, GSP plus scheme with duty free entry to EU came into operation, but firms have to satisfy the rules of origin conditions where one has to fulfill the regional cumulative criteria that inputs should be from SAARC countries (Kelegama, 2005:95).   The EU has implemented a new EU_GSP system based on an assessment of core human and labor rights, good governance and environmental conventions, this came into effect in January 2006. It is expected that Sri Lanka can benefit from this duty free access to the market (Sri Lanka Garment Buying Association. 2005)

Although Sri Lankan government signed the Free Trade agreement with India that came to effect in 2000, it has not been successful in exporting garments to India mainly due to various non-tariff barriers in the Indian market and rules of origin governing the agreement (Kelegama, 2005:96).

Conclusion

It may be too early to assess the complete impact of the MFA phase out that came into effect in January 2005 and how the Sri Lankan garments sector responded to the emerging trends. According to one study there have been 15 factory closures affecting about 3000 workers during the period from January to October 2005. These workers have received little or no compensation from the employers. Out of the 15 factories 14 are from rural areas and workers would have been hard pressed as a result. The study also confirmed that there are some more factories being considered for closures due to their inability operate and survive competition. (Prasanna and Gowthaman, 2005). Most of these factories are small and medium scale. This trend in factory closures was expected by some and have been warned about quite early, as far back as 2002 (JAAF).

In a recent study by Kelegama (2005) a similar conclusion was arrived at. Commenting on the two view points (Optimistic and Pessimistic) he concludes that the "scenario in Sri Lanka will be something in between the two scenarios

explained above. If one examines the composition of the Sri Lankan garment industry , one finds that 549 firms (64 per cent) are categorized as small and 204 (22 per cent) as medium. It is these two categories of firms that are highly dependent on quotas and on buying offices. These firms will lose orders after 2004 and face losses. Some of them would be acquired by the 12 percent large firms, some will be used by large firms for subcontracting activities, and some others will have to close down. ……Based on the current trends of the closure of (garment) industries, it can be stated that there will be at least 80,000 job losses consequent to the MFA phase-out. Most of ….those lose jobs will be female workers who belong to the low grade unskilled category" (Kelegama, 2005: 91).

It appears that the large and some medium sized firms have taken the challenges very seriously and are making necessary adjustments in their production and marketing. Efforts to secure new markets as well as expand the existing ones are being made both by the government and the JAAF. The government has been making some efforts to negotiate new agreements with multilateral agencies for trade facilitation and with countries such as USA for duty free access to their market. At firm level most large firms (MAS Holdings group and Brandix Lanka group) with strong market links appear to be quite confident in their ability face future. Some big firms have merged themselves and became stronger, while a few other Sri Lankan firms have established shareholding companies with foreign partners. Even the middle level firms have taken certain measures to upgrade their production and improve productivity by introducing modern technology at least in a limited way, although these may not be adequate in future. The Tables given below highlight the extent to which these measures and changes have been introduced by the 14 factories surveyed by the authors.

Table-13 Measures Taken to Reduce the
 Unit Cost of Production
(Multiple answers)

Type of Measure	No of Factories
Reduce use of electricity (economize)	1
Reduce use of other inputs	1
Increase efficiency	8
Improve quality	2
Reduce wastage (inputs)	4
Reduce overheads	1
Reduce staff by computerization	2
New machinery	4

Table-14 After MFA - whether
Sales Improved

	No of Factories
Improved	4
No change	7
Reduced	3

Table-15 Methods of Adjustment
Before and After - MFA Period. (Multiple answers)

Method of Adjustment	No. of Factories
Developing brand names	3
Downsizing	1
Improve productivity	12
Expand/new Markets (domestic /foreign	14
Reduce prices	8
Improve Quality	12
Change product type/Product diversification	7
Factory modernization	9
Merges/alliances	5
Improve management	9
Provide better facilities to workers	10
Improve environmental standards	8
No need to adjust (has strong market)	1

While the threats to garment industry in Sri Lanka is real, so far more than one year after the Phasing out of MFA, the export earnings from garments have been increasing. There is optimism prevailing among some firms who have taken necessary steps to modernize production capability and improve quality their products. Sri Lanka's strength of being a quality garment manufacturer for the mass market, its labor and environmental standards, compliance record with ILO regulations, the educated, trainable and disciplined labor, the absence of labor disputes within industry as well as the reputed international customer base will perhaps work more favorably. In spite of these positive qualities, more will have to be done by the individual firms in industry and the government. The government will have to play a bigger role in the form of maintaining macro economic stability (non inflationary economy), provision of better infrastructure facilities, financial assistance for upgrading technology and improving

productivity, international negotiations and training facilities for all categories of labor.

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Appendix

Survey of Garment Factories in Sri Lanka

The survey of 14 garment factories was carried out by the authors during the period September to December in 2005. Factories were selected from four districts: Colombo, Kandy, Anurapdhapura and Badulla (Mahiyanganaya area) and information was collected from both management and employees. The two groups were interviewed separately using two different sets of questionnaires. The management was interviewed in great detail on various aspects covering, production, labor issues, marketing, exports, facilities available to workers, responses to MFA phase out etc. Tables prepared on the basis of the data collected are given below (Tables 1-41).

In the employees category the total number interviewed were 140, selected from 13 factories. One factory could not grant permission to interview employees without the approval from the head office. Approximately 10-12 employees belonging to various categories excluding management level were selected for this purpose. The main focus of this questionnaire was to asses their working conditions, wages, facilities available to them, their future expectations etc.

Table 1 - Whether industry under BOI or not

BOI	12
Not Under BOI	2

Table 2 - Number of Factories in the Group

One	6
Two	1
Three	2
Four	1
Five	2
Over 20	2

Table 3 - Year of Establishment

Before 1980	2
1980-1990	2
1991-2000	5
2001 & After	5

Table 4 - Capital Ownership (Share holding)

100 % Sri Lankan	8
Share holding (foreign & local	6

Table 5 - Number of Employees

100-200	3
201-300	1
301-500	3
500 -700	4
701-1000	2
Over 1000	1

Table 6 - Whether total number of workers has increased over the years after 2000

Yes	7
No Change	6
Reduced	1

Table 7 - Distribution of Management/ Supervisory Staff

Number of factories with more males	9
Number of Factories with equal or more females	5

Table 8 - whether Exports (value)
Increased over the years after 2000.

Yes	10
No change	2
Reduced	1
No information	1

Table 9 - Subcontracting

Production given on sub contract to other factories	6
Production taken on subcontract from others	8
None	3

Table 10 - Tax Concessions

Received when established	13
Tax concessions still receiving	10

Table 11 - Whether member of Garment Exporters Association

Yes	10
No	4

Table 12 - Facilities Provided to Employees by the Factory

Facility	No. of Factories
1) Restaurant	9
2) Free/subsidized meals	13
3) Transport	9
4) Hostel/accommodation	2
5) Medical facilities	12
6) Recreation	7
7) Other	10

Table 13 - whether Facilities are
Effective in Increasing Efficiency

Yes	3
To Some extent	9
No answer	2

Most products are for middle and lower end of the market (although some claim they produce to the middle market, in fact they are lower end market products.

Table 14 - Products Sold Directly to the
 Buyer (representative) or Intermediary

Buyer Representative	7
Intermediary	7
To contractor (other	1

* (multiple answers in one factory) these buyers have buying offices in Colombo,

* Production done according to specifications given by the buyers (all said yes.)

Table 15 - Buy Inputs from a Manufacturer
Recommended by the Buyer.

Yes (all)	6
Some proportion	7
From another source	1

All brand names belong to buyers.

Brand names: Mark & Spencer, Gap, Next, Columbia, Tesco, Jodash, Stafford, Pierre Cardin, Snickers, Makenley, Manson, Dimension, Clubroom, Charter club, Jenifer, Worldwide, Bimion bay, Cheroke, Messima,

Table 16 - Do You Have Bargaining Power over the Price

Yes	1 *
To some extent(negotiate)	11
No	2

* (offer good prices, no need to bargain)

Table 17 - What Agents / Buyers insist on
(Number of factories)

Competitive prices	14
Quality improvements	13
Meeting deadlines	14
Ethical requirements (compliance	12
Welfare	13

Table 18 - How Do You Respond to Above Challenges (multiple answers):

Update technology (new machinery)	5
Plan to meet deadlines	3
Bear the cost deadlines cannot be met	1
Design accordingly	5
Improve productivity	1

Table 19 - Are you in a Position To Face these Challenges?

Yes	8
To Some Extent	6
No	-

Table 20 - Do you have flexibility in Production so as to meet deadlines? Have you faced Difficulties in this regard?

Yes	8	Yes	7
To some extent	6	Some times	3
		No	4

Table 21 - How did you respond to those (Multiple answers by 11)

Working overtime	4
Air freighting	4
Try to get extensions (after explaining)	6

Table 22 - Have you been able to become competitive

Yes	9
To some extent	5

Table 23 -Where do you need further Improvement?
 (Multiple answers)

Productivity improvement	3
Competitive prices	1
Technology improvement	5
Experts/ specialists (manpower)	1
Staff commitment/motivation	3
Compliance facilities	2
Quality improvement	2
Infrastructure	1
need continued improvement	1

Table 24 - Whether any Steps Taken to Upgrade Technology

Yes	11
In a limited way	1
No	2

Table 25 - If yes, what Changes have you introduced. (Multiple answers)

New Machinery	12
Improve labor productivity	3
Air conditioning	2
Develop New Designs	2
Improve quality	2

Table 26 - If those Helped Improve Productivity

Yes	12
No answer	2

Table 27 - If not, do you plan to upgrade technology:

Yes,	1
No (Financial problems)	1
Continue upgrading	8

Table 28 - Has the Management Taken Measures to Restructure Factory

Yes	8
No	6

Table 29 - Labor Related Problems (multiple answers)

Absenteeism	14
Lack of interest	6
Indiscipline	3
Inadequate training	8
Not willing to work over time	1
Shortage of labor	9
Labor leaving company	14

No labor union activity in any of the factories

Workers council in 11 factories.

Table 30 - Relationship between Management and Workers

Very good & production is enhanced	4
Good, but has no influence on production	8
No answer	2

Table 31 - Recruitment of Labor (multiple answers)

Advertisement	8
Personal contact	5
Through other workers	10
Go in search of workers	4
Other methods	1

Table 32 - Do you provide training to workers

Yes	13
No	1

Table 33 - Categories of Labor given training
 (Multiple answers):

Management	10
Supervisory	8
Machine operators	11

Table 34 - where Training is given

Within factory	14
Outside Institutes	9

* Training updated by 10 factories

Table 35 - Are you satisfied with your production planning capability?

Yes	9
To some extent	2
No	3

Table 36 - If not Why? (Multiple answers)

Not flexible enough	2
Capacity limitation	1
Need more improvements in efficiency	4
Raw material delay	3

Table 37 - Are you satisfied with HRM?

Yes	10
No	2
To some extent	1

Table 38 - Measures Taken to Reduce Unit Cost of Production (Multiple answers)

Reduce use of electricity (economize)	1
Reduce use of other inputs	1
Increase efficiency	8
Improve quality	2
Reduce wastage (inputs)	4
Reduce overheads	1
Reduce staff by computerization	2
New machinery	4

Table 39 - Main Problems of the Factory

Inadequate infrastructure	8
Labor problems	11
Short of capital/finance	8
Lack of skilled labor	10
Lack of state support	9
Markets for the products	2
Inadequate training facilities	4
Other	3

Table 40 - after MFA - Abolition of Quotas whether Sales Improved?

Improved	4
No change	7
Reduced	3

Table 41 - Firm's Method of Adjustment for the Post- MFA Period. (Multiple answers)

Method of Adjustment	No. of Factories
Developing brand names	3
Downsizing	1
Improve productivity	12
Expand/new Markets (domestic /foreign	14
Reduce prices	8
Improve Quality	12
Change product type/Product diversification	7
Factory modernization	9
Merges/alliances	5
Improve management	9
Provide better facilities to workers	10
Improve environmental standards	8
No need to adjust (has strong market)	1