東非：將成為下一波的服飾採購中心?

■ 百字摘

低勞動成本優勢逐漸在亞洲新興國家消失，加上去年至今，油價與匯率波動、消費型態改變，使傳統服飾供應鏈慢慢從亞洲轉向非洲，尤其東非的衣索比亞與肯尼亞最具發展潛力，有望成為各國服飾生產與採購戰略地點，可好好關注該區發展，以掌握先機。

■ 原文整理

前言：

過去一年內，亞洲國家工資水準的提升、匯率政策的轉變，全球零售趨勢與消費者行為的變化，使已開發國家的服飾業者面臨服裝採購上的挑戰。與此同時，政治與投資的變化，讓有潛力從事服飾業生產的新市場誕生，儘管過去這些市場在全球服飾採購上只扮演一小角色。

全球知名服飾品牌與零售商,如一些歐洲公司(H＆M、Primark及 Tesco)，已於過去二年開始自衣索比亞採購服飾。事實上，自2013 年後不僅是衣索比亞，其他東非國家亦逐漸成為潛在的服飾採購來源國。另外，因預期為 39 個非洲國家提供進入美國市場免關稅的「非洲增長與機會法案(AGOA)」將再續約，使非洲市場更備受關注。

為瞭解什麼是東非成為主要服飾採購中心的潛力，該文作者走訪了該地區的工廠，訪問製造商與買方等利害關係人，作了市場數據分析，亦對 40 位服裝採購人員[1]進行問卷調查。研究發現，東非確實有成為服裝採購中心的潛力，但前提是，利害關係人，如買方、政府及製造廠商須先攜手合作，改善區域的商業環境。

因受總體經濟趨勢影響，現今服飾業者的採購策略已被複雜

[1] 將受訪的 40 位服裝採購主管於 2014 年的服裝採購量加總起來，金額達 700 億美元。

化：歐美於經濟壓力下所實施的金融政策，引發了匯率波動。過去六個月，美元兌一籃子貨幣的匯率上漲了 15%，同時，歐元兌美元卻下滑 25%。這些匯率的動盪也對大宗商品的價格造成衝擊，如石油價格大幅下滑，許多已開發國家的利率也達歷史新低。

原本由大多數已開發市場出口服飾的情況已有了改變。政治的不穩定與勞動爭議的增加，使服飾業價值鏈面臨崩解的風險。不斷上升的勞動成本也為買方帶來挑戰，亦使在傳統採購據點經營的業者，開始重新思考其現有的運營模式。➔受訪者認為，影響其採購成本增加的三個主要原因為勞動成本、匯率、及原物料成本。

已開發國家服飾業的成長停滯，以及預期未來消費市場會有變化，使服飾業者開始重新思考其採購來源與建構供應鏈的策略。未來業者需要有更高的靈活度，更多的採購據點，更好應對小批量及快速回應市場的能力。此外，未來該行業需走向跨業合作，而不再僅是單打獨鬥的經營模式，因此產品的合規性就變得相當重要。

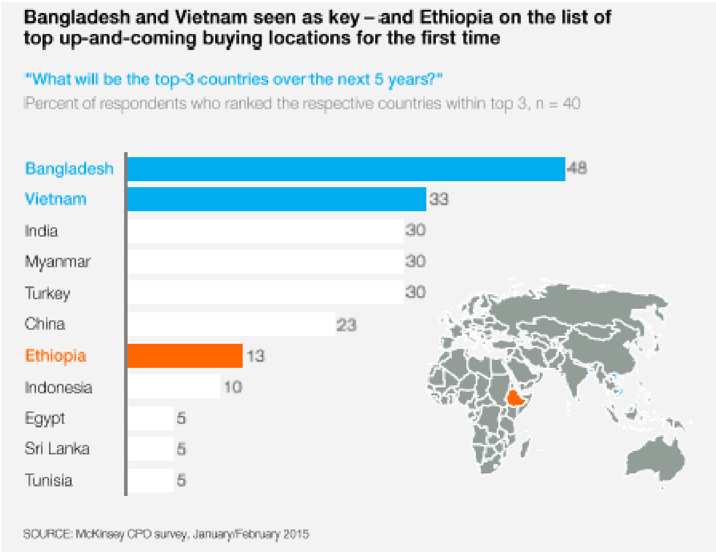
嶄露頭角的採購中心

近四分之三的受訪採購人員表示，他們預期未來五年會減少對中國大陸廠商的服飾採購量。雖有人擔心這會為中國大陸的服飾企業帶來危機，但其實可能不會，因為中國大陸正轉向發展國內市場，以供應他們正在崛起的中產階級的需求，為此，中國大陸的代工廠已逐漸轉向投資發展自有品牌，並透過如T-商城等的線上消費市場，來展示新品牌。所以，雖然 2010 年後中國大陸的服飾生產已下滑，但相信中國大陸於全球服飾外包市場的主導地位、消費結構的變化，及其中產階級的興起，仍將使中國大陸維持其成衣製造的龍頭地位。[2]

另外注意的是，許多中國大陸的服飾製造商正轉往柬埔寨、越南、緬甸及其他服飾來源國設廠，運用低廉的勞動與資源及貿易協定，提供具吸引力的價格來滿足全球服裝採購者與國內市場的需求。

[2] 2013 年中國大陸服飾出口量達 1,770 億美元。

此外，問卷調查結果亦顯示，有 48%的受訪採購人員表示，孟加拉將是今後最重要的服裝採購來源國。且有 62%的人表示，他們打算在未來五年內，增加對孟加拉的服裝採購。另外兩個服裝採購中心是越南和印度，分別有 59%與 54%的受訪者表示會增加對這兩國的採購。然而，將孟加拉(240 億)、越南(170 億)、及印度(170 億)的服飾出口量加總起來，仍不及中國大陸服飾出口量的三分之一。另，值得關注的是，第一次有非洲國家出現在"重要服飾採購地點"的排行榜上，尤其衣索比亞還名列第七。



<u>東非機會</u>

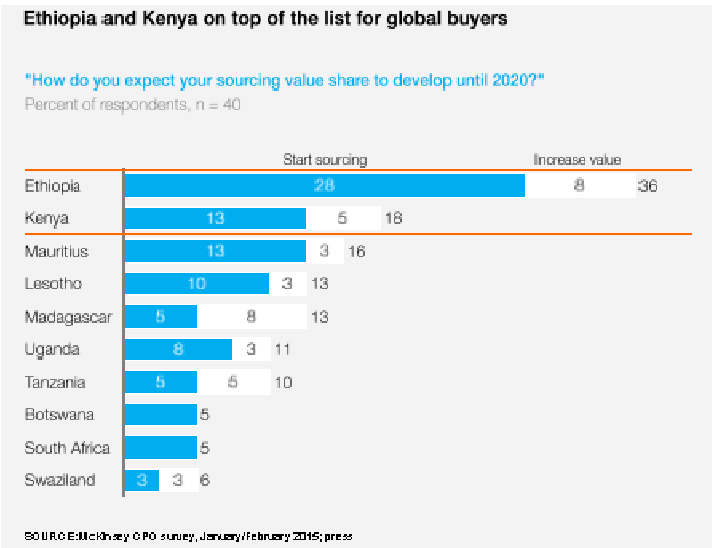
根據聯合國的預測，撒哈拉以南非洲地區的勞動年齡人口在未來 20 年裡的增長速度將快過任何地區。到 2035 年，預計該地區的勞動年齡人口將達現今中國大陸勞動年齡人口的水準(超過 9 億人)。這種大規模的勞動資源正被多個產業關注，服飾業也不例外。而受訪者亦預期，2020 年他們在撒哈拉以南非洲的採購比重將比現今更多。儘管目前該區遠銷西方市場的數量仍少，但若受訪者所言確實，那麼在未來五年內撒哈拉以南非洲的服裝出口量可能呈指數式的成長。

以國家別來看，33%的美國受訪買家意識到撒哈拉以南非洲地區對他們的重要性，然僅 11%的歐洲採購人員有同樣認知。從產業角度分析，以價值為導向的業者會看重撒哈拉以南非洲地區的發展，但屬於中間市場的服飾業者則較不看重。另外，有 28%

的受訪採購人員已向撒哈拉以南非洲的國家採購服飾，其中超過50%是直接與當地供應商採購，不到 15%是透過亞洲供應商的營運總部來採購，另有 32%透過代理商來採購。

而撒哈拉以南非洲地區能成為採購中心的潛力在於該區多數地方皆尚未開發。WTO 的全球出口數據顯示，2013 年整個非洲大陸的服飾出口額維持在 99 億美元左右，且大多數的出口來自北非國家，如摩洛哥和突尼斯，而不是撒哈拉以南非洲的國家。若只探討撒哈拉以南非洲地區的前 10 大服裝出口國可知，它們的出口僅占全球服裝出口額的 0.55%而已。

以當前的服飾出口動力及該行業的複雜程度來評估哪個非洲區域具服裝外包能力，結果顯示，在撒哈拉以南非洲地區，東非國家，尤其是衣索比亞和肯尼亞，或較小的烏干達與坦桑尼亞，是最受服飾採購商青睞的地方，如美國最大品牌商與零售商，以及一些歐洲零售商(包括一些具影響力的時尚玩家)，都開始在衣索比亞和肯尼亞從事採購活動。受訪者指出，未來五年這兩區域將成為他們重要的採購據點。另一方面，衣索比亞及肯尼亞政府亦正利用法規及一些激勵措施，來發展其國內的紡織服飾業，以作為國家工業化與經濟發展的工具。



不過，發展紡織服飾業，衣索比亞及肯尼亞各有其優勢與劣勢：衣索比亞有成本優勢，而肯尼亞則有較高的生產效率。在挑戰方面，兩國面臨的相同挑戰為，基礎設施建設落後、海關程序

繁瑣、技術與管理人才缺乏、以及社會與環境合規性低。

衣索比亞

1939 年衣索比亞的第一個紡織廠在德雷達瓦成立，至今該行業仍顯鬆散，且成長緩慢。儘管衣索比亞於 2001 年加入 AGOA，但該法案對衣索比亞的影響微乎其微，直到 2005 年該國政府與土耳其及德國建立工業及發展夥伴關係後，才開始有了轉變。2007 年由土耳其掌權的紡紗廠開始營業，隨後更將業務擴展至針織、印染、及製作服飾等方面，並將產品賣給德國主要買家，促進了衣索比亞服飾業的額外成長。

2010 年，衣索比亞政府將服飾業加至其「增長與轉型計劃」中，並開辦紡織工業發展研究院。自那時起，該國政府已推出許多吸引投資的措施，以支持其服飾業的發展。2015 年第二階段的「增長與轉型計劃」，更大幅增加對服飾業的支持，以期實現他們的遠大目標。

過去兩年有許多關於衣索比亞的議論出現，因為歐美開始重視該區，一些整合業者(如來自土耳其和亞洲的CMT[3]服裝製造商)也開始在該區投資與經商，甚至鄰國肯尼亞的企業都在衣索比亞設立商店。但即使今日的服飾採購商偏好自衣索比亞採購基本、大量的服飾[4]，但根據WTO資料顯示，衣索比亞的服飾出口僅占全球總服飾出口的 0.01%而已[5]。不過一些美國和歐洲買家正仔細觀察衣索比亞的潛力，且最近新的「國家AGOA中心」已成立，該中心將使衣索比亞出口商更容易地進入美國市場。

但為何衣索比亞會受服裝採購商的重視呢?訪談與問卷調查的受訪者表示，最主要原因在於成本上的考量：衣索比亞服飾業的人工工資全球最低(每月低於 60 美元)，且外籍人士的工作許可證申請費用不到肯尼亞的十分之一。此外，衣索比亞的電費也較低廉，因該國水力發電強大。但因電網不太可靠，所以衣索比亞

---

[3] CMT：來料加工 (Cutting, Making, Trimming)。

[4] 衣索比亞出口至歐盟 15 國的 T-shits 與褲子各占其總出口的 46%與 31%。

[5] 以出口地區來看，衣索比亞的服飾 60%是出口至德國，主要是與歐盟簽有免關稅協定及該國政府努力發展該行業有關，另僅有 10%出口至美國，顯示儘管衣索比亞與美國簽有免關稅協定(AGOA)，但該協定對衣索比亞出口美國的影響尚不大。

政府正為目前的新工業區開發一個獨立電網。

再者，受訪者認為衣索比亞有一天將可能成為服飾原料的來源國，因其擁有超過 320 萬公頃的土地與適合種植棉花的氣候，但至今，該土地利用率還不到 7%。事實上，低土地利用率、以往規劃失誤、低作物產量、及當地棉花品質等問題，是造成衣索比亞不得不進口棉花的原因[6]。而衣索比亞所面臨的難題還有社會責任[7]、生產效率低(含交貨時間長)[8]、及缺乏中間管理人才與技術[9]等問題。

肯尼亞

2008 年，肯尼亞政府將服飾業列入重點發展產業的名單，預計推動國家工業化，作為其「肯尼亞 2030 遠景」的一部分，因此計劃和實施了多項措施，來支持該產業的發展。

如同衣索比亞，肯尼亞的服飾業目前專注於提供大量基本的服飾(如褲子)，占其所有出口至美國產品的 58%。最小訂單為 10,000 件，而大型廠商則至少都有 25,000 到 50,000 件的訂單量。

從歷史上看，肯尼亞已從 AGOA 獲利，對 AGOA 的依賴度相當高：據聯合國商品貿易統計資料庫顯示，2013 年該國 92%的服裝是出口至美國。受訪供應商表示，歐盟經濟夥伴關係協定對該國的利益較小：整體免稅利益少於 AGOA，且與亞洲低成本國家間的競爭很激烈，因為那些亞洲國家也與歐盟簽屬優惠協議。一些肯尼亞廠商表示，他們並不急於拓展業務至歐洲，因為歐洲買家對交貨時間、訂單規模及品質的要求較為嚴苛。

近年來肯尼亞製衣廠的產能顯著成長，主要是因為來自亞洲與中東地區的外國直接投資增多，以及肯尼亞政府發展出口加工區的緣故。工廠實力不斷壯大，現在平均約有 1,500 名員工，與 2000 年的 560 人相比，增加許多，且效率也更佳。

6 69%受訪採購人員認為缺乏原料是在衣索比亞經商的挑戰。

7 社會責任議題，如服飾製造商使歐洲企業糾纏於佔據衣索比亞奧莫河谷後，使有機棉的種植遭遇挫折。

8 目前生產效率約在 40%-50%之間，有 80%受訪採購人員認為影響衣索比亞成為服務採購中心的挑戰是生產無效率。

9 57%受訪採購人員認為缺乏中間管理人才是很大挑戰； 所有受訪者(訪談及問卷調查)中，有 65%認為缺乏技術是衣索比亞的大挑戰。

然而，由於當地缺少服飾業的上游產業，製造商必須進口布料，所以交貨時間較長(於海外進口布料時，從通關至運送到工廠需 40 天時間)。再者，受訪的製造商與買家表示，在肯尼亞開展業務的另一個挑戰是其勞動成本相對較高(服飾業員工的每月工資約在 120 至 150 美元間)。肯尼亞的能源成本也高，且因為電力來源複雜，工廠往往要依賴發電機。在非洲，利用發電機發電較運用電網輸電的費用貴了 4 倍。

就像衣索比亞一樣，肯尼亞若想吸引更多國際買家，它將需要解決合規性與風險問題。據該研究受訪採購人員表示，腐敗、高犯罪率、及缺乏社會責任是他們在肯尼亞面臨的主要挑戰。

<u>東非未來展望</u>

該文作者為東非建立三個情境，來作為分析的一部分，尤其針對衣索比亞、肯尼亞、坦桑尼亞及烏干達的未來十年展望作分析。2013 年，這四個國家的服飾出口總額達 3.37 億美元。

第一種情境，東非仍將持續為利基市場，並假定與美國及歐盟的自由貿易協定將繼續。但在貨幣與股票市場的動盪下，該地區的前景仍相當有限，預估該區 2020 年出口成長至 5 億美元，2025 年成長至 7 億美元。

第二種情境，假設東非將成為幾個大型服飾公司基本服飾的新採購來源地，使該區出口額倍增。於該假設下，東非服飾公司將擴充業務至剪裁、製作及修剪(CMT)等方面，且朝垂直整合邁進，但這可能需數年時間方能達成。預估於該情境下，2020 年該區的出口成長可達 10 億美元，2025 年則成長至 17 億美元。

第三個情境則假設全球大型服飾公司開始在東非設立辦事處，使該地區吸引足夠的投資來升級設備與招攬技術人工，且其出口量將接近如墨西哥及巴基斯坦等國水準。但即使在這種情況下，它仍需花數年時間來做垂直整合，扶植國內廠商發展，且須國家共同合作來建立區域價值鏈，才有可能實現。於該情境下，預估 2020 年出口成長可至 12 億美元，2025 年成長可至 30 億美元。

<u>創造永續的未來</u>

為充分開發東非的潛力，所有利害團體須與政府、供應商及買方廣泛合作，並盡一切努力來發展社會與環境的合規性。當世界各地正面臨勞動成本、風險及產能問題時，東非更加有發展服飾產業的潛力。倘若所有利害關係人能夠共同努力解決問題，建立雙贏，其經濟發展的潛力會很大。

服飾業是改善當地經濟的引擎，所以公部門官員與地方政府應執行長期發展計劃，強化區域貿易結構(如簽署 FTA、支援貿易市場)、改善基礎設施建設、支持當地企業及吸引 FDI、支援供應產業與向後整合、及建立市場導向的教育機構。

對供應商來說，現正是超越 CMT 工作，擴大提供產品與客戶投資組合的時機，所以他們應改進生產效能(如透過新機器來增進生產效率)、增加員工或管理階層的職訓機會、促進產品多樣化、與買家建立長期夥伴關係、投資向後整合項目。

對採購者來說，現正是將該地區從試點角色轉向與當地供應商建立長期合作關係的時機。因此，採購方可讓東非地區成為他們採購的戰略據點，而非短期試驗場域。該地區需要合作夥伴與投資，以作好未來融入全球的準備。

總結

若希望東非服飾製造業能持續成長，所有利害關係人間的合作是必要的。例如政府可考慮是否投資基礎設施建設，支持當地企業家，簽署多種自由貿易協定，並建立以市場為導向的教育機構。供應商將需要改善其生產效能與增加管理人員培訓機會，升級設備與提供多樣化的產品組合，並與買家建立長期夥伴關係。另外，各方亦皆需要盡一切努力來使社會及環境合乎規定。對買方來說，買家可支持東非供應商在能力建構上的努力，並開始將該區視為其採購戰略地點，而非僅是試驗場域而已。

AUGUST 2015

Retail and Consumer Packaged Goods

East Africa: The next hub for apparel sourcing?

East African countries—in particular, Ethiopia and Kenya—have the potential to become bigger players in garment manufacturing. But the road ahead won't be easy.

Achim Berg, Saskia Hedrich, and Bill Russo

In the past two years, a number of European companies—among them, H&M, Primark, and Tesco—began sourcing some of their garments from Ethiopia. The rest of the apparel industry took notice: since 2013, there has been rising interest in not just Ethiopia but also other East African countries as potential sourcing destinations for apparel. Also contributing to the buzz is the renewal of the African Growth and Opportunity Act (AGOA), which gives certain countries in sub-Saharan Africa duty-free access to the US market.

What is the true potential of East Africa to grow into a major garment-sourcing hub? To find out, we visited factories in the region; interviewed stakeholders, including manufacturers and buyers; and analyzed market data. In addition, we conducted our third survey of chief purchasing officers (CPOs), this time with a series of questions focused on East Africa. This year, 40 apparel CPOs, representing a combined $70 billion in 2014 purchasing volume, responded to our survey. We found that East Africa could indeed become a more important center for apparel sourcing, but only if stakeholders—buyers, governments, and manufacturers—work together to improve business conditions in the region.

Up-and-coming sourcing countries

Nearly three-quarters of survey respondents said, as they did in 2011 and 2013, that over the next five years they expect to reduce their purchases from Chinese firms. Chinese apparel production has indeed fallen since 2010—but China remains the undisputed giant of garment manufacturing, with approximately $177 billion in apparel exports in 2013.

Among CPOs surveyed, Bangladesh remains at the top of the list of future sourcing destinations, with 48 percent of respondents including the country in their top three (Exhibit 1). And 62 percent said they intend to increase their sourcing value from Bangladesh over the next five years. The next two up-and-coming countries are Vietnam and India, where, respectively, 59 percent and 54 percent of surveyed CPOs plan to increase their sourcing value in the next five years. Yet the combined apparel exports of Bangladesh ($24 billion), Vietnam ($17 billion), and India ($17 billion) still amount to less than one-third of China's.

For the first time in our survey, African nations appear on the list of countries expected to play more important roles in apparel manufacturing. Ethiopia, notably, is seventh on the list.

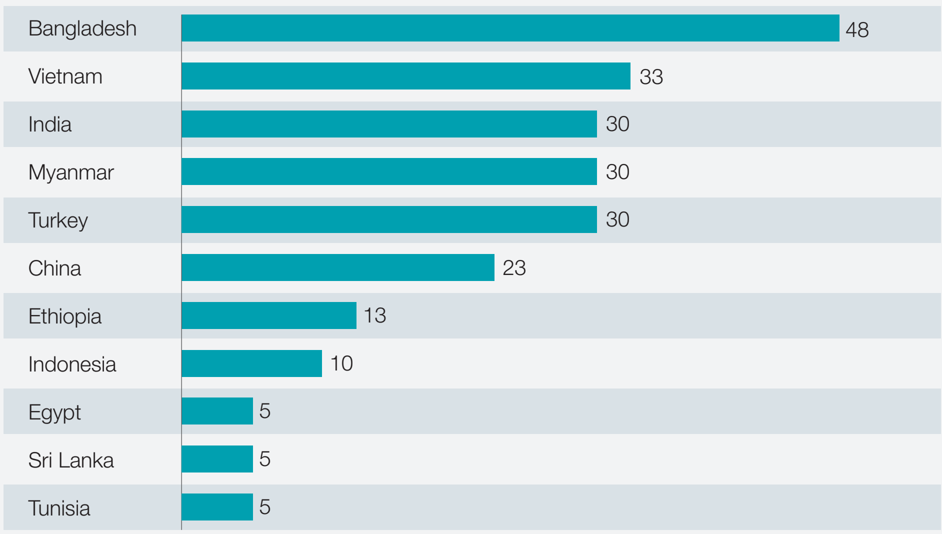
The East Africa opportunity

According to United Nations projections, sub-Saharan Africa will have the highest growth in working-age population anywhere over the next 20 years. By 2035, the working-age population in the region is expected to be as large as China's today—more than 900 million people. This massive labor pool is capturing the attention of several industries, including apparel.

Exhibit 1 **Bangladesh remains the top future sourcing location; Ethiopia appears on the list for the first time.**

"What will be the top 3 sourcing destinations over the next 5 years?"

Respondents who ranked the respective countries within the top 3, n = 40, %



Source: McKinsey survey of chief procurement officers, January/February 2015

Within sub-Saharan Africa, East African countries—especially Ethiopia and Kenya, and to a lesser extent Uganda and Tanzania—are of interest to apparel buyers (Exhibit 2). The governments of both Ethiopia and Kenya are taking steps to develop their domestic textile and garment industries.

Each of the two countries has strengths and weaknesses. Our research and interviews revealed, for example, that Ethiopia has cost advantages whereas Kenya boasts higher production efficiency. Challenges common to both countries include poor infrastructure, cumbersome customs processes, a dearth of technical and managerial talent, and low levels of social and environmental compliance.

Ethiopia

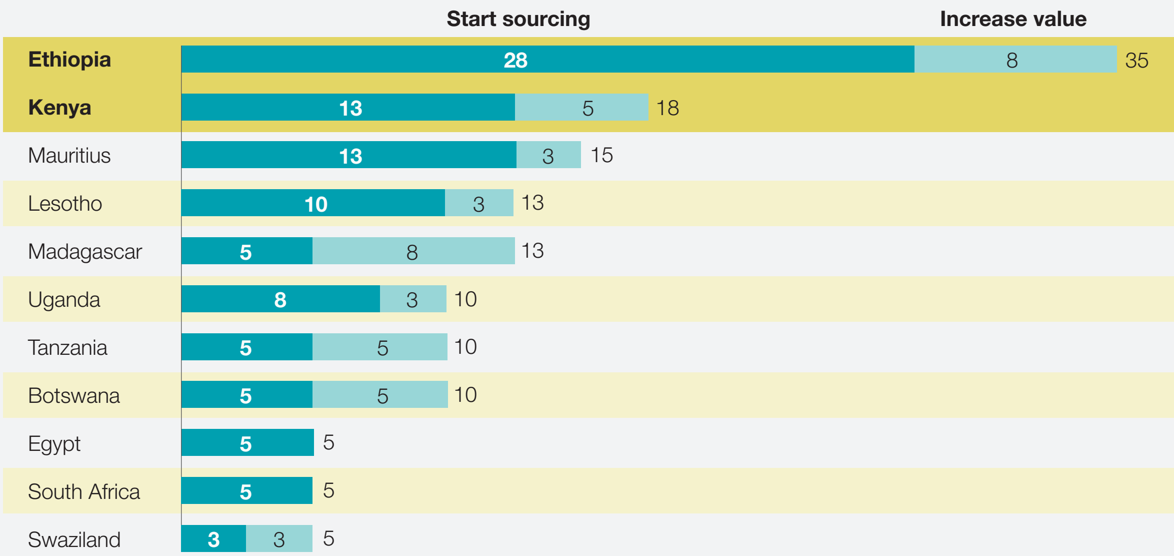
Apparel buyers today are sourcing basic, large-volume items from Ethiopia: T-shirts accounted for 46 percent of the country's exports to the EU-15, and trousers 31 percent. As much as 60 percent of exports are sent to Germany and 10 percent to the United States. But Ethiopia accounts for a mere 0.01 percent of total apparel exports, according to the World Trade Organization.

Why, then, is Ethiopia such a hot topic for apparel buyers? Our interviewees and survey respondents said the biggest reason is cost: Ethiopia's wages for garment workers are among the lowest globally, at below $60 per month, and work-permit costs for foreign workers are less than one-tenth those in neighboring Kenya. Additionally, Ethiopia has low electricity prices. The country has a strong supply of hydroelectric power, and while the power grid is not the most reliable, the Ethiopian government is building a separate grid for new industrial zones currently under development.

Exhibit 2 **Among sub-Saharan African countries, Ethiopia and Kenya are of greatest interest to global buyers.**

"Do you expect to either start or increase sourcing from these countries between now and 2020?"

Respondents, n = 40, %[1]



[1] Figures may not sum, because of rounding.

Source: McKinsey survey of chief procurement officers, January/February 2015

Ethiopia could someday become a source of raw materials: it has more than 3.2 million hectares of land with a suitable climate for cotton cultivation. Yet, barely 7 percent of that land is being used today. The combination of low land-utilization rates, planning errors, low crop yields, and quality problems means Ethiopia has had to import cotton. Social compliance has also been an issue. For example, organic-cotton cultivation recently suffered a setback after garment manufacturers supplying European firms became entangled in land-grabbing accusations in Ethiopia's Omo Valley.

Another problem is production efficiency, which currently runs between 40 and 50 percent, and long lead times. Eighty percent of the CPOs in our survey cited production inefficiency as a challenge to the growth of apparel sourcing in Ethiopia.

Kenya

Like Ethiopia's, Kenya's apparel industry currently specializes in supplying high-volume bulk basics such as trousers, which account for 58 percent of its exports to the United States. The typical minimum order size is 10,000 pieces; the country's larger players have minimum order sizes of 25,000 to 50,000 pieces.

Kenya has benefited greatly from AGOA—92 percent of its apparel exports in 2013 went to the United States, according to UN Comtrade. Suppliers we interviewed said the EU's Economic Partnership Agreement isn't as much of an incentive: the overall duty-free advantage is less than that of AGOA, and the competition with low-cost Asian countries is stiff, as they too are benefiting from preferential agreements with the European Union. Some Kenyan manufacturers said they aren't eager to expand their business to Europe because they perceive European buyers as more demanding with respect to lead times, order sizes, and quality.

The capacity of Kenya's garment factories has grown markedly in recent years, thanks to foreign direct investments from Asia and the Middle East, as well as support from the Export Processing Zones developed by the Kenyan government. Factories have grown larger and more efficient; they now have around 1,500 employees on average compared with around 560 in the year 2000.

However, as a result of the lack of a local upstream industry, manufacturers must import fabrics—which means considerably longer lead times. Fabrics from overseas can take up to 40 days to make their way through customs and to a garment factory. Manufacturers and buyers alike said that another challenge of doing business in Kenya is comparatively high labor costs, with monthly wages for garment workers in the $120 to $150 range. Energy costs are also high, and because the power supply is spotty, factories often have to rely on generators. In Africa, power from generators works out to be four times as expensive as power from the grid.[1]

Like Ethiopia, Kenya will need to address compliance and risk issues if it is to attract more international buyers. According to the CPOs we surveyed, corruption, high crime rates, and poor social compliance are among the core challenges they face in Kenya.

Future scenarios for East Africa

As part of our analysis, we created, tested, and refined three scenarios for the evolution of East Africa—in particular, Ethiopia, Kenya, Tanzania, and Uganda—over the next decade (Exhibit 3). In 2013, these four countries' apparel exports totaled $337 million.

The first scenario is that East Africa will remain a niche market. This scenario assumes that free-trade agreements with the United States and the European Union will continue.

Exhibit 3 **We see three scenarios for the future of East Africa as a sourcing hub.**

	Scenario 1 'Niche market'	**Scenario 2 'The new alternative'**	**Scenario 3 'Toward next mainstream'**
Description	Market remains volatile; buyers with existing presence increase volume, others launch pilots	Selected large companies regularly source basics from the region, yet it remains largely untapped for most players	Industry upgrading happens; more players from around the world open a sourcing office in the region
Potential ($ billion), 2020	~0.5	~1.0	~1.2
Potential ($ billion), 2025	~0.7	~1.7	~3.0

Source: McKinsey analysis

If East Africa is to experience sustainable growth in garment manufacturing, collaboration among all stakeholders is a must.

In part as a result of volatility in currencies and equity markets, the prospects for the region will remain rather modest.

In the second scenario, East Africa becomes a new sourcing option for several large players in the basics categories, and the region's apparel exports more than double. In this scenario, East Africa's garment companies move beyond cut, make, and trim facilities[2] and embark on the path to vertical integration—but this process could take several years.

A third scenario assumes that major apparel companies from around the world begin to open sourcing offices in East Africa. The region attracts enough investment to upgrade facilities and recruit skilled workers, and its export volumes approach those of countries such as Mexico or Pakistan. But even in this scenario, it could take years for vertically integrated, indigenous players to appear in the region—and that might be achievable only if the countries cooperate to build regional value chains.

If East Africa is to experience sustainable growth in garment manufacturing, collaboration among all stakeholders is a must. Governments, for instance, might consider whether to invest in infrastructure, support local entrepreneurs, diversify free-trade agreements, and build market-oriented educational institutions. Suppliers will need to embrace performance improvements and management training, upgrade their facilities and offerings, and enter into long-term partnerships with buyers. All parties will need to make every effort to ensure social and environmental compliance. Buyers, for their part, would do well to support the capability-building efforts of East African suppliers and begin to evaluate the region as a true strategic option rather than just a testing ground.

[1] Antonio Castellano, Adam Kendall, Mikhail Nikomarov, and Tarryn Swemmer, *Brighter Africa: The growth potential of the sub-Saharan electricity sector*, McKinsey & Company, February 2015, mckinsey.com.

[2] Cut, make, and trim (CMT) factories do not supply fabrics. Apparel buyers must select and buy all the fabric, trimmings, and other components. Workers at the CMT factories then use those fabrics to make the garments.

This article is adapted from *Sourcing in a volatile world: The East Africa opportunity*, an April 2015 report from the Apparel, Fashion & Luxury Group in McKinsey's Retail Practice.

The authors wish to thank Benedikt Berlemann for his contributions to this article and the research that underlies it.

Achim Berg is a principal in McKinsey's Frankfurt office, **Saskia Hedrich** is a senior expert in the Munich office, and **Bill Russo** is a director in the Nairobi office.

McKinsey&Company

Sourcing in a volatile world
The East Africa opportunity

Apparel, Fashion & Luxury Group April 2015

Authored by:
Achim Berg
Benedikt Berlemann
Saskia Hedrich
Karl-Hendrik Magnus
Ben Mathews
Bill Russo

Sourcing in a volatile world – the East Africa opportunity

Within the last year, macroeconomic developments such as increasing wage levels across Asia and the big shifts in foreign exchange rates, as well as global retail trends and changing consumer behaviors, have complicated the challenge of sourcing for apparel companies across the developed world. At the same time, political changes and investment shifts allow new countries to emerge as potential sources for apparel production even in parts of the world that previously played only small roles in apparel sourcing.

Africa, in particular, has received a great deal of attention thanks to the high publicity around the sourcing activities in East Africa of some of the leading global apparel brands and retailers, and to the expiration and the expected renewal of the African Growth and Opportunity Act (AGOA), which provides 39 African countries with duty-free access to the US.

Compared to parts of the world with advanced garment industries, how does East Africa[1] compare? And what is the potential of East Africa to grow into a major garment-sourcing hub? To answer these key questions, we visited factories, interviewed stakeholders, analyzed granular market data, and focused the third edition of our survey of chief purchasing officers (CPOs) on this intriguing region. This year 40 CPOs, representing the full spectrum of the global apparel industry, responded to our survey on recent sourcing trends, the expected shifts in the global sourcing map, and East Africa specifically. The survey participants, combined, represent around USD 70 billion in sourcing expenses in 2014, so their perspectives, in combination with our rigorous analysis, form a well-rounded perspective on this volatile market.

THE MACROSTATE OF PLAY IN 2015

The apparel sector is facing a significant number of recent trends that are complicating the sourcing strategy for all players. Among the macroeconomic trends that impact sourcing, financial policy implemented due to economic pressures in Europe and the US led to a rise in currency exchange rate volatility, with the US Dollar Index rising more than 15 percent over the last six months, against a basket of currencies. At the same time the euro has declined by 25 percent versus the dollar. These currency fluctuations also have roiled the commodity markets, none more so than the price of oil, which has fallen sharply. Interest rates are also at historic lows across much of the developed world.

Looking at the regions where most of the clothing worn in the developed markets is made, a different picture emerges. Political instability and an increase in labor disputes are factors that inject risk of disruption into the apparel value chain. Rising labor costs are also challenging buyers, as well as players in some of the traditional sourcing strongholds, to rethink existing operating models.

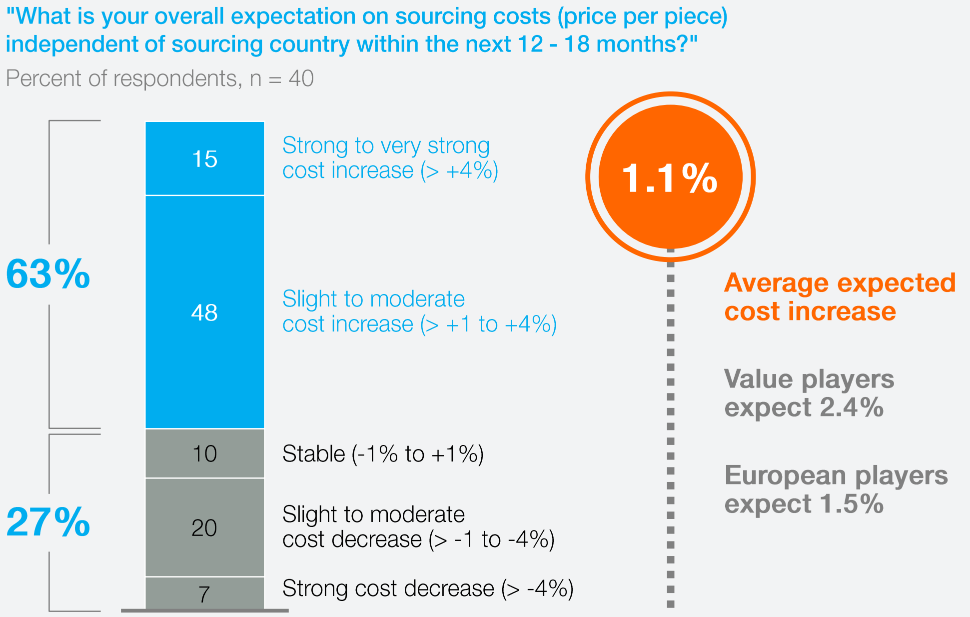
The majority of our CPO survey participants foresee increasing prices against historically low inflation rates, independent of sourcing country. Value players are most bleak in their outlook expecting a cost increase of around 2.4 percent in the next year, and European players are less optimistic than the average given recent currency trends (see Exhibit 1).

---

1 We focus on four East African countries: Ethiopia, Kenya, Tanzania, and Uganda.

Exhibit 1

Almost 2/3 of respondents expect price increases



SOURCE: McKinsey CPO survey, January/February 2015

When we asked respondents to discuss the specific drivers of the changes in cost, labor costs are still top of mind for the majority, but as to be expected, European CPOs cited the impact of foreign exchange rates as their top concern. In the third place, respondents listed raw materials costs as a key driver (see Exhibit 2).

Stagnating apparel markets in the developed world and expected future shifts of consumer markets are leading apparel players to rethink their sourcing and supply chain setups. The rise of omnichannel and fast fashion require players to adapt to higher flexibility, more collections, the ability to deal with small batch sizes, and quick responses. Additionally, compliance is more important than ever, as the industry increasingly seeks joint solutions instead of "everybody on their own" behavior.

Navigating the volatility

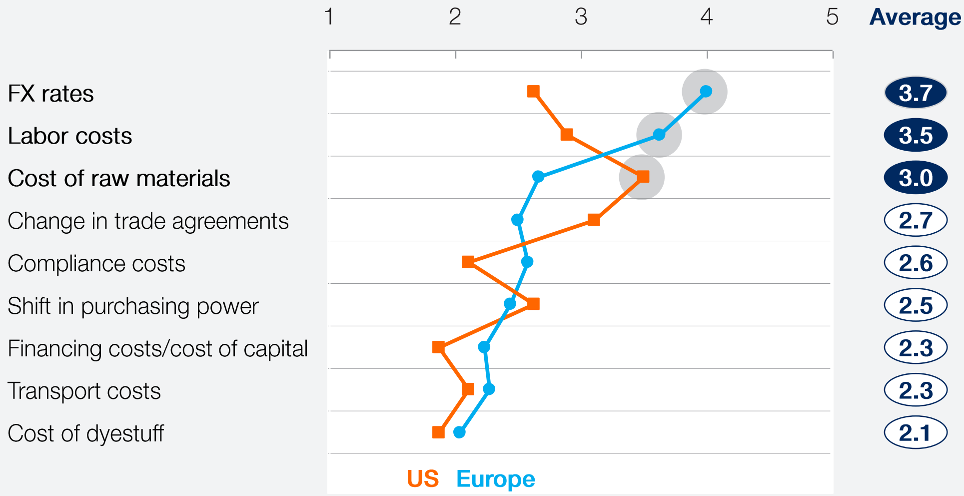
From our work on the optimization of apparel sourcing with retailers and brands internationally, we believe we have some ideas that may help apparel buyers reduce or rein in the volatility they encounter in their sourcing strategies. The four suggested actions presented below are not a complete risk elimination program, but rather elements of a broader plan that buyers may consider along with an analysis of their existing sourcing strategies. In all, we believe these steps could make a positive contribution to a more balanced sourcing strategy. They are:

Exhibit 2

Labor costs are still a key driver, but FX rates are the top-of-mind issue for European players today

"Which drivers do you expect to have the highest impact on sourcing cost development within the next 12 months?"

Assessment of respondents, 1 = no impact, 5 = very high impact, n = 40



SOURCE: McKinsey CPO survey, January/February 2015

1. **Optimize country selection:** Our work suggests that apparel companies should consider the costs, capacity, speed, quality, and compliance of their sourcing portfolios and reflect on the mix of these factors when allocating their sourcing activities in various countries. Most companies will strive for a balance of countries to have the right mix for different product types and needs. This also creates flexibility in the sourcing options so buyers can allocate production in low-cost currencies to balance out production in high-cost locations. In addition, a balanced portfolio should reduce the impact of external events, such as political struggles and labor/compliance problems.

2. **Improve supplier management:** We believe apparel companies should establish a professional supplier management program, which helps identify, develop, and retain strategic suppliers. As part of that effort, they should create systematic evaluations for each supplier and establish differentiated relationships (for example, strategic versus transactional suppliers), which will allow for quick analysis of the key accounts. This segmentation also helps buyers prioritize investments in the strategic suppliers within their footprint. Negotiations are an important aspect of working with suppliers, and we recommend holding structured talks with detailed cost comparisons. In addition, we believe that one focus of negotiations should be the locking-in of long-term prices for critical fabrics and materials.

3. **Manage risks:** All sourcing activities are exposed to risks that should be addressed from within the overall sourcing strategy. For example, what can be done to limit the risk of operational disruptions or improve resource management? How can a company

reduce the environmental impact in its value chain? How can the company get credit for its positive actions, and improve collaboration with all stakeholders? These issues impact not only costs, but brand perception and consumers' assessment of the overall value of the company's products. As a result, buyers should develop clear guidelines and codified procedures to manage social and environmental compliance.

4. **Aim for end-to-end efficiency:** Lastly, we believe apparel companies should aim for end-to-end efficiency. This includes, for example, the optimization of supplier operations with lean manufacturing programs, as well as the leveraging of technology and tools to streamline processes from design oversampling to production. They should also consider using design-to-value techniques to identify savings potentials early on in the design process.

While we focus this article on the changes in the sourcing landscape on a country level, which is aligned with point number one above, we hasten to note that it is important to integrate all four levers into any well-rounded sourcing strategy.

The changing sourcing landscape: 2015 CPO survey results

Given all of these disruptive elements, how are CPOs from western fashion companies reacting? After the phase-out of the Multifiber Agreement[2], apparel sourcing has largely concentrated on China as the manufacturing powerhouse of apparel. However, buyers increasingly were starting to diversify into other low-cost Asian sourcing countries, as best exemplified by the rise of Bangladesh. But even that conversation has gotten markedly more complicated in recent years.

However, nearly three-quarters of our respondents continue to say, as they did in 2011 and 2013, that they expect to decrease their allocation to Chinese firms over the next five years. One might feel this spells trouble for Chinese firms, but so far export statistics do not reflect the statements of the CPOs. Additionally, China is turning more and more of its apparel production capacity toward its own domestic market serving its growing middle class. To do this Chinese OEMs increasingly invest in developing their own brands supported by the easier access to consumers online, as the emergence of new brands on the online platform T-Mall shows. Though Chinese production of apparel has fallen since 2010, we believe the dominance of the global apparel-sourcing market, the mix change toward Chinese consumers, and the substantial size of its growing middle class, will keep China the apparel production powerhouse for the foreseeable future.

It is also important to note that many of China's garment makers are now looking to open facilities in Cambodia, Vietnam, and Myanmar, as well as in other up-and-coming sourcing countries, in an effort to tap into lower-cost labor pools and utilize trade agreements to better feed both the global garment buyers and the domestic market at an appealing price point. In addition, CPOs are always on the lookout for the next great opportunity in sourcing, and increasingly, there are new names on the list of up-and-coming buying locations. For

[2] Between 1974 and 1994 the Multifiber Agreement subjected garment exports to quotas limiting the volumes sourced mainly from developing countries. After the ten-year phase-out which ended in 2004 China was the main beneficiary of sourcing shifts to the Far East, growing its share of global clothing exports from 22 percent in 2004 to 39 percent in 2013 (WTO).

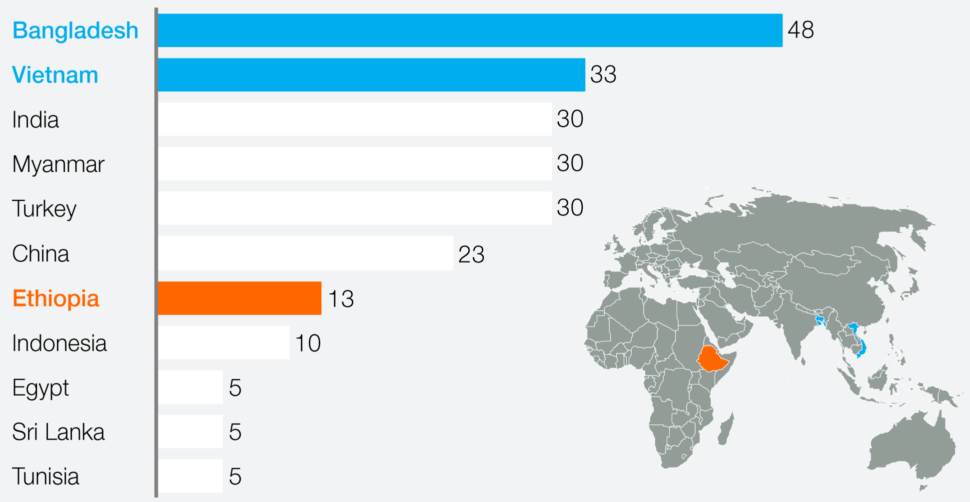
international CPOs Bangladesh remains the top future sourcing destination, as 48 percent of respondents put it in the top-3 up-and-coming sourcing markets. Sixty-two percent of our respondents said they intended to increase their sourcing value from Bangladesh over the next five years, indicating that the forecast annual growth rate of 7 to 9 percent in our 2011 report still stands[3]. Other top-3 sourcing countries include Vietnam and India, where respectively 59 percent and 54 percent of responding CPOs plan to increase their sourcing value in the next five years (see Exhibit 3).

Exhibit 3

Bangladesh and Vietnam seen as key – and Ethiopia on the list of top up-and-coming buying locations for the first time

"What will be the top-3 countries over the next 5 years?"

Percent of respondents who ranked the respective countries within top 3, n = 40



SOURCE: McKinsey CPO survey, January/February 2015

We must note that even these three top countries combined export only one-third of the dollar value coming from China currently. China remains the undisputed giant of garment exports, with eight times the dollar volume of exports than the number two Asian apparel sourcing country, Bangladesh. Vietnam and India are tied for third place, with roughly USD 17 billion in exports shipped each. Despite high growth over recent years neither country poses a threat to China’s dominance at the moment, as all are facing their individual challenges in terms of political stability, garment industry structure, or competitiveness. Only over the longer term is China’s manufacturing base expected to weaken due to macroemployment trends. A recent report by the McKinsey Global Institute[4] forecasts China’s labor pool could shrink by one-fifth over the next 50 years. But any trend that is expected to play out over 50 years is only just beginning to be visible in the distance, in 2015.

[3] “Bangladesh’s ready-made garments landscape: The challenge of growth,” McKinsey, November 2011

[4] Growth: Can Productivity save the Day in an Aging World?” McKinsey Global Institute, January 2015

While low-cost Asian sourcing is one sourcing theme, proximity sourcing has developed into a serious alternative for apparel companies. The importance of proximity sourcing is increasing, as 68 percent of our respondents indicated in their survey submissions. European CPOs, it should be noted, reported this theme being a priority even more fervently, with 78 percent agreeing to the statement. Especially for small and medium-sized players, the CPOs expect near shoring to increase over the next five years.

THE EAST AFRICA OPPORTUNITY

From our extensive work with leading apparel buyers, and on-the-ground experience in these markets, we know there is much interest among apparel executives in the next market for garment sourcing. There is a general agreement that the “next China,” if you will, does not exist and as we noted above, there is no single market likely to absorb that much of the business anytime soon. However, there are attractive candidates in other parts of the world that might help an apparel company improve the balance in its sourcing footprint. None of them are immediately ready to take on substantial volumes, but an analysis of population trends can point to potential contenders over the longer term.

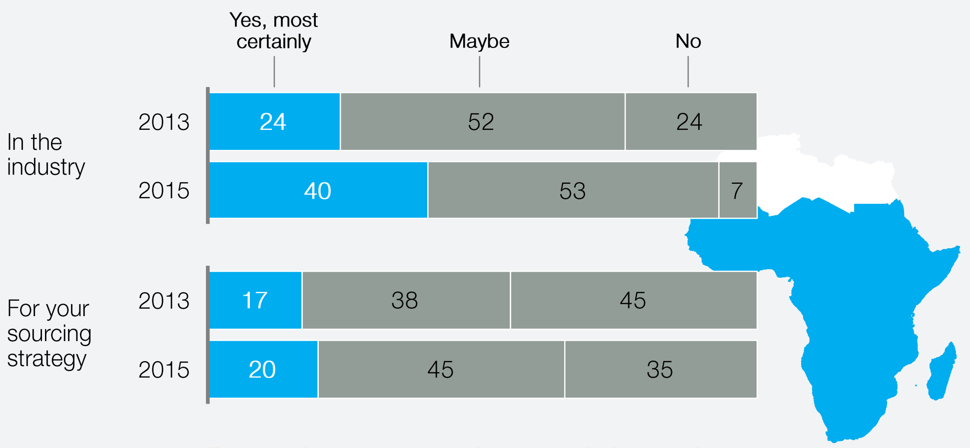
Population trends point toward sub-Saharan Africa, as it is expected to enjoy the most energetic growth in working-age population anywhere over the next 20 years. By 2035, the working population in the region is expected to pull even with China today. While this is encouraging, we believe that sub-Saharan Africa must be understood at a granular level because the degree of each country’s development and potential for garment exports differs.

Exhibit 4

Sub-Saharan Africa is seen a potential "watering hole" for the industry, but few players have concrete plans

"Will sub-Saharan Africa gain importance over the next 5 years?"

Percent of respondents, 2013: n = 29, 2015: n = 40



Respondents expect to increase their sourcing share from sub-Saharan Africa from 0.3% to 2.8% by 2020[1]

1 Excluding responding CPOs from South Africa, including their increase from 1.3 to 3.6 by 2020

SOURCE: McKinsey CPO survey, July/August 2013; McKinsey CPO survey, January/February 2015

Our CPOs, when asked to assess the prospects for the importance of sub-Saharan Africa over the near term, noted they expect to be sourcing a greater share of their overall portfolio from the region in 2020 than they are in 2015. Granted, the dollar volume exported to western markets at the moment is small, but if those figures are borne out, the sub-Saharan share could grow exponentially in the next five years (see Exhibit 4).

The geographic split once again presents itself, with 33 percent of US buyers noting the rising importance of sub-Saharan Africa for their own sourcing strategies, while only 11 percent of European CPOs agreed with that statement. The same is true among industry segments, with more interest from value-oriented players and premium players, but less for middle-market apparel companies.

Of the 28 CPOs already involved in sourcing from sub-Saharan countries, a bit more than half deal directly with local suppliers. Not quite 15 percent source via Asian suppliers' headquarters, and 32 percent source via agents.

It is important to mention that sub-Saharan Africa's potential as a sourcing hub is largely untapped at the present moment. The global export data from the World Trade Organization shows the export value of clothing from the continent as a whole stood at USD 9.9 billion in 2013, but the majority of those exports came from the countries in North Africa, such as Morocco and Tunisia, rather than the sub-Saharan nations.

Exhibit 5

Today, top-10 garment-exporting countries in sub-Saharan Africa account for only 0.55% of global exports

East Africa

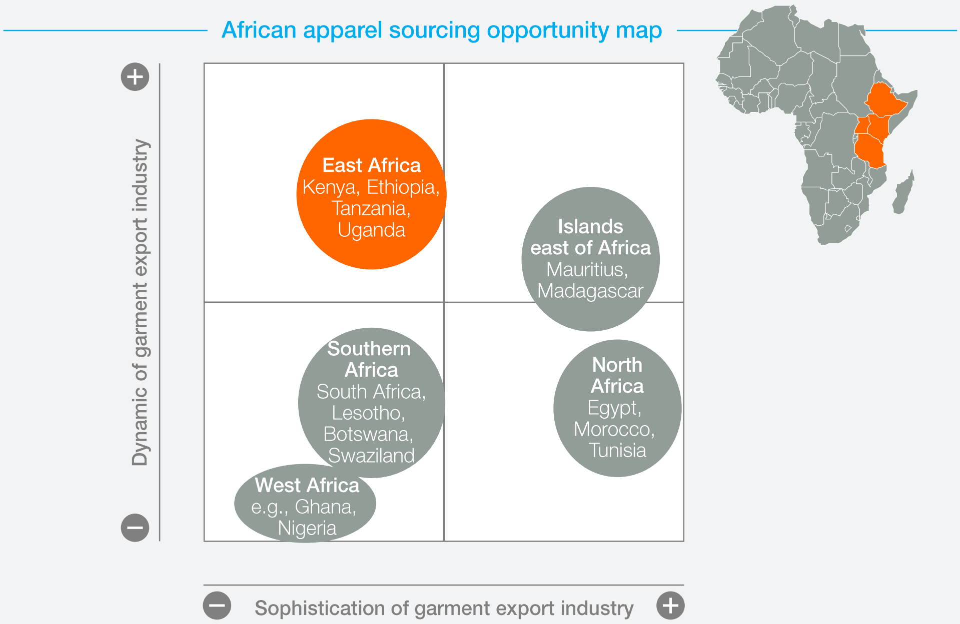
	Apparel exports, 2013 USD millions	Percent of world exports	Approx. number of apparel factories	Population 2014 Million people
Mauritius	761.3	0.17	174	1.2
South Africa	502.9	0.11	450	53.1
Lesotho	417.9	0.11	43	2.1
Madagascar	381.1	0.08	71	23.6
Kenya	279.3	0.06	22	45.5
Botswana	72.4	0.02	~ 10	2.0
Swaziland	52.8	0.01	~ 18	1.3
Ethiopia	36.5	0.01	66	96.5
Tanzania	17.0	0.004	22	50.8
Malawi	10.6	0.002	< 10	16.8
	Σ USD 2,531.6 m	Σ 0.55		

With USD 337 m East African countries Kenya, Ethiopia, Tanzania, and Uganda account for 0.07% of global exports

SOURCE: SWTO; UNCTAD UN DESA; EPZA Kenya; Mauritius Export Association; Lesotho Textile Exporters Association; TIDI Ethiopia; press; SAPI Swaziland Investment Promotion Agency; BIDPA Botswana Institute for Development Policy Analysis; MFDP; International Business & Trade TZ Initiative

Exhibit 6

East African countries are the most dynamic for global apparel sourcing



SOURCE: McKinsey CPO survey, January/February 2015; interviews; McKinsey

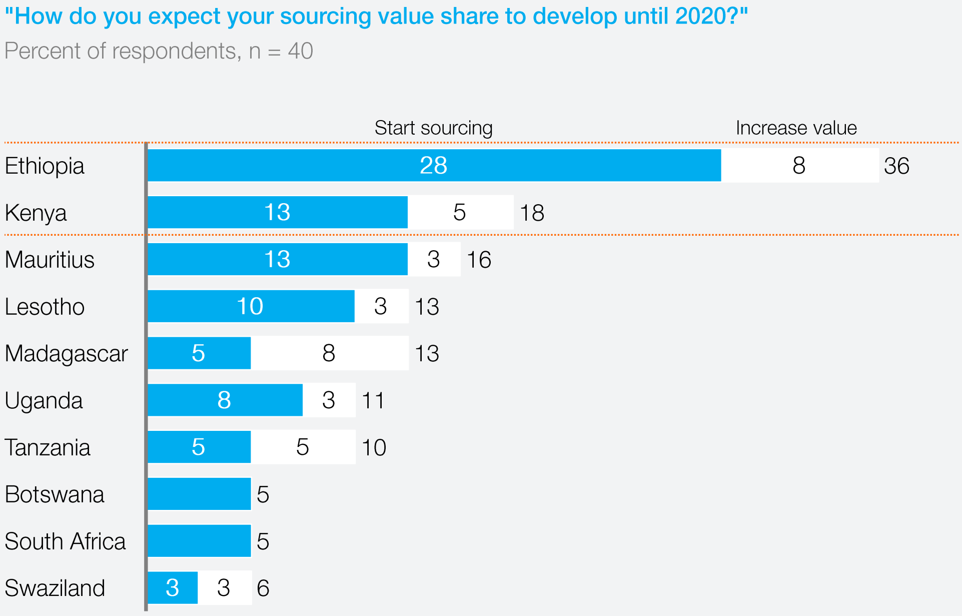
If we examine the top-ten garment-exporting nations in sub-Saharan Africa, we see they collectively amount to only a 0.55 percent share of global apparel exports. However, many governments in the region are using legislation and incentives to leverage the textile and apparel industries as tools for the broader industrialization and economic development for some of the least-developed countries in Africa (see Exhibit 5).

In assessing the various African regions where one might invest in garment-sourcing capacity, we analyzed each region in terms of the dynamism of its current garment export industry, as well as the industry's sophistication. Given the low volumes of exports noted in Exhibit 6, it quickly becomes apparent that East Africa has the preferred mix of high dynamism and decent sophistication. Later in this report we will present deep dives on Kenya and Ethiopia, two neighboring nations with high potential but also significant differences in their garment industries (see Exhibit 6).

Global buyers' preferences also indicate real interest in those specific countries, Kenya and Ethiopia. The largest US brands and retailers, as well as selected European retailers, including some of the influential fast-fashion players, have begun sourcing in these locations. Over the next five years, many respondents indicated that these two markets will occupy more share in their sourcing portfolios (see Exhibit 7).

Exhibit 7

Ethiopia and Kenya on top of the list for global buyers



SOURCE: McKinsey CPO survey, January/February 2015; press

A closer look at Kenya and Ethiopia

If one examines recent legislation in these two nations, it is clear that both are taking steps to encourage and develop their domestic textile and garment industries.

As shown in Exhibit 8, the two countries share the traditional strengths and weaknesses of nascent apparel-sourcing countries. Infrastructure in both countries is a challenge, with roads, rails, and ports being challenging to navigate for many players. The number of trained garment workers at present is also a limitation for Kenya and Ethiopia. It is clear from the analysis that Ethiopia has certain advantages in terms of costs, whereas Kenya's garment industry has reached higher productivity levels. In all, either one has the potential to gain share in the global apparel-sourcing market.

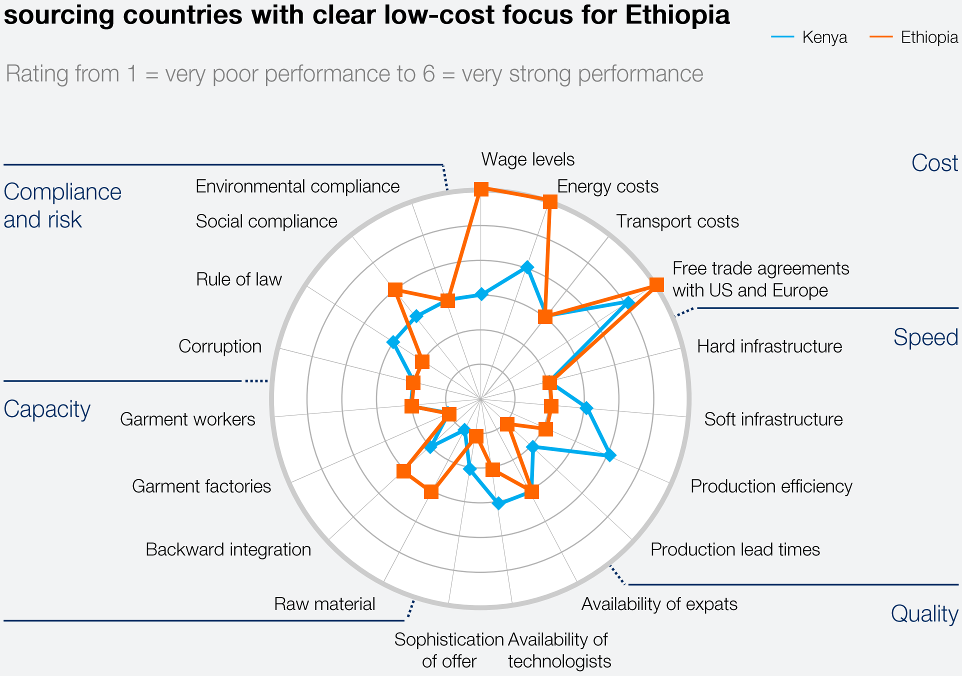
Future scenarios for Kenya and Ethiopia

As part of our analysis, we created, tested, and refined a set of scenarios describing the future evolution the four East African markets, Ethiopia, Kenya, Tanzania, Uganda, with most apparel-sourcing potential over the medium term. As with any prognostications, caveats apply. For example, each of these scenarios presumes that the region enjoys a degree of political stability and economic progress, while avoiding conflict, natural disasters, compliance issues related to rapid growth or other negative outcomes. Here, the gradations between one scenario and another hinge upon the level of volatility in global currency markets, the investments patterns of garment manufacturers as well as the willingness of suppliers and global apparel buyers to invest in East Africa.

Exhibit 8

Both countries show typical strengths and weaknesses of nascent sourcing countries with clear low-cost focus for Ethiopia

Rating from 1 = very poor performance to 6 = very strong performance



SOURCE: EPZA Kenya; European Commission Tariff database; FAO, ILO, ITUC, TIDI Ethiopia; Transparency International; UN Comtrade; USITC; WEF; World Bank; World Justice Project; WTO; press; interviews; McKinsey

As you can see in Exhibit 9, the first scenario is the most conservative, assuming that East Africa will remain a niche market over the next decade. Much of the success or struggle in this scenario depends on the existence of free trade agreements with the US and the European Union. If there is continued volatility in currencies and equity markets, the prospects for the region will remain rather modest, as that volatility will impact the level of foreign domestic investment that can be made. The scenario assumes that buyers with existing relationships will continue their purchasing, and other vendors will launch pilot initiatives in the region. As a result, we calculate exports would grow to USD 500 million over the next five years, which roughly equals the growth rate of the region in the past few years, at around 5 percent per year, and roughly USD 700 million in annual exports over the next ten years. If this scenario wins out, by 2020, the region will still remain a small slice of the global sourcing market, but of course the industry's impact will still be important for the region.

The second scenario suggests that East Africa might become a new alternative for selected large players in the basics categories, and the level of investment will rise at a faster pace. Even that limited uptick could double the region's exports. That said, in this scenario the majority of the apparel industry is still doing business elsewhere, and the region's exports grow to USD 1 billion a year over the next five years, and USD 1.7 billion per annum over the next decade. In this scenario, we believe East Africa could move beyond cut, make, and trim (CMT) facilities and find itself on the path to verticalization, but we hasten to note that this process could take several years before significant numbers of vertically integrated, indigenous players appear in the region.

Exhibit 9

3 scenarios for the future of East Africa as a sourcing spot are possible

	SCENARIO 1 "Niche market"	SCENARIO 2 "The new alternative"	SCENARIO 3 "Towards new mainstream"
DESCRIPTION	Continued volatility of the markets. Buyers with existing presence extend volume, others as pilot	Darling for a few – East Africa will work out for selected large players for basics	Turbo charge – if industry up-grading happens, more players from different regions will open a sourcing office there until 2020
POTENTIAL (USD billions)	2020: ~ 0.5 2025: ~ 0.7	2020: ~ 1.0 2025: ~ 1.7	2020: ~ 1.2 2025: ~ 3
EVALUATION	While no substantial impact on the worldwide sourcing landscape, the industry's importance for East Africa still on the rise	More and more large inter-national companies see the value from East Africa sourcing and strategically invest in partners/infrastructure	East Africa with growth rates like Bangladesh over many years. However, in total the importance of world exports stays moderate

SOURCE: McKinsey

Our third scenario assumes that East Africa attracts a great deal of attention, growing at a rate even comparable to Bangladesh's historic growth while becoming a major force in the apparel industry over the next decade. At that pace, the industry base across the region will quickly attract the funds to upgrade facilities and attract skilled workers. Over the next decade, should this scenario play out, East Africa's export volumes could approach countries such as Mexico or Pakistan on apparel industry league tables. This spectacular export growth could see the region's output rise to USD 1.2 billion a year over the next five, and approximately USD 3 billion per annum over the next ten years, which equals an average annual growth rate of around 20 percent. As with the second scenario, here also we believe East Africa could move beyond CMT facilities and find itself on the path to verticalization. Even in this more energetic scenario, it could take several years for vertically integrated, indigenous players to appear in the region. Also, this overall growth in the region might be only reachable if the countries cooperate to build regional value chains.

Now that we have sketched out possible scenarios and growth rates, we will transition to examining the two East African markets that already have achieved a certain amount of success in the apparel business, and have economies that provide stable climates for business and the rule of law.

The Kenya opportunity

In 2008 the Kenyan government added the garment industry to its list of focus industries that it expects will drive the country's industrialization, as part of its "Kenya Vision 2030" program, and implemented several measures to support the industry's development.

Historically, the growth of the Kenyan apparel industry was driven almost exclusively by the duty-free access it enjoys from the US, via the AGOA legislation that came into effect in 2001. The dependency on the US is high with 92 percent of garment exports in 2013 delivered to the US according to UN Comtrade. Suppliers we interviewed mentioned the free-trade benefits of AGOA frequently as one of the core advantages for Kenya, but see the European Partnership Advantage as less beneficial due to preferential agreements that the EU has with core low-cost Asian countries and the overall lower duty-free benefit. At the same time Kenyan manufacturers perceive European buyers as more demanding, in terms of quality, order sizes, and adherence to lead times. Only some of the existing suppliers in Kenya are considering expanding their customer base to Europe so far. That presents some risks, as AGOA in the past was on short renewal cycles only, and any loss of AGOA would immediately have detrimental impact on the industry – as the recent developments in Swaziland show. However, those risks are not the complete story for Kenya.

> “We are aiming for a balance to reduce dependency on AGOA” *Manufacturer*

On the positive side of the ledger, Kenya’s garment industries’ capacity has grown markedly in recent years, thanks to foreign direct investments mainly in CMT factories[5] by investors from the Middle East and Asia[6] and supported by the Export Processing Zones developed by the Kenyan government. The strategic decision power as well as the customer relationships of these companies remains largely in the hands of the foreign headquarters, while the local entities focus solely on production. It has not been straight-line growth, by any means; there have been many up years and down years, due to the dependency on US buyers and the limited importance within the global sourcing market overall. However, the remaining factories have grown into more efficient entities over the last 15 years, with around 1,500 employees on average today versus only around 560 in 2000.

> “All fabrics and all trims and accessories are imported – only packaging is local” *Manufacturer*

Kenya’s industry currently specializes in supplying high-volume bulk basics, and the quality level for the basic products is known to be good. However, due to the lack of a local upstream industry, fabrics have to be imported and are mainly sourced from China. Seventy percent of CPOs responding to our survey perceive this lack of upstream industry as posing a high/very high challenge. Sixty-six percent also noted the lack of raw materials in Kenya. Due to reliance on import of quality fabrics, knit and woven products from cotton and man-

[5] CMT factories are factories working with fabrics bought or nominated by the buyers and focusing on the making of the garment.

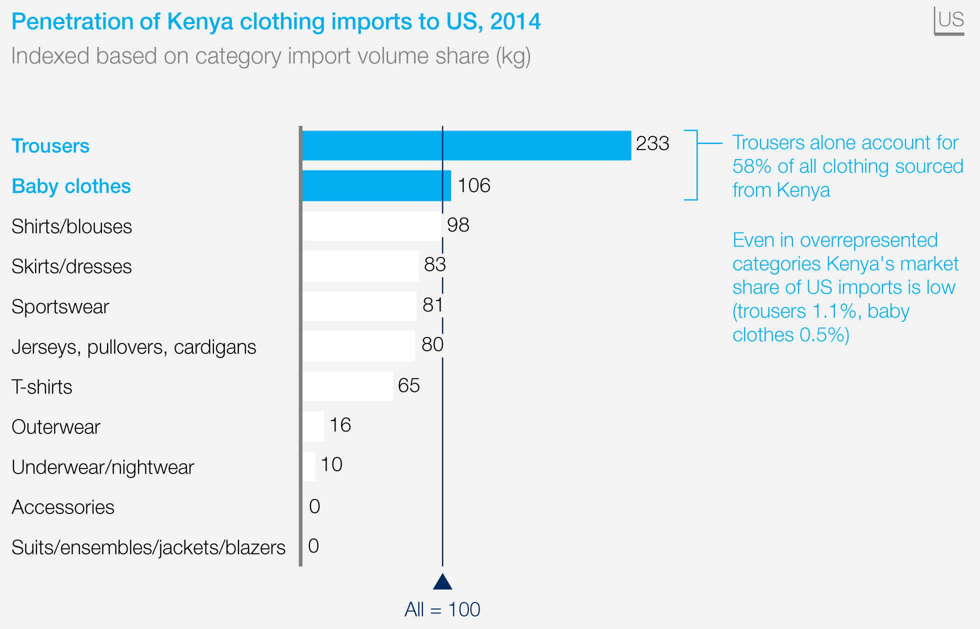
[6] Today, many of the top Kenyan exporters are foreign-owned. A World Bank report noted that of the 18 companies operating in the country’s Export Processing Zones in 2011, two-thirds were owned by transnational owners, whereas diaspora investors held a 28 percent share, and only one of the companies was owned by an indigenous investor (“Making foreign direct investment work for sub-Saharan Africa,” 2013).

made fibers are relatively evenly present in the Kenyan industry. To foster investments in textile mills, the Kenyan government is working to lower electricity costs and is lobbying for changes to AGOA to extend the time that the preferential trade window stays open.

Trousers alone account for 58 percent of the clothing exported from Kenya to the US. Jersey items come in second place. The typical minimum order size is 10,000 pieces, and the country's larger players are used to shipping in volumes of 25,000 to 50,000 pieces (see Exhibit 10).

Exhibit 10

US buyers know Kenya mainly for trousers and sportswear



SOURCE: USITC; McKinsey

If there are constraints on building additional capacity at the moment, Kenyan exporters are hindered by the limited availability of skilled employees. Manufacturers also state that the skill gap in technical roles exists even in cases where people have the educational background from local institutes, as they typically seem unfamiliar with manufacturing at mass production levels. Half of our CPOs see the lack of qualified technologists as a high/very high challenge and 58 percent of respondents in our survey see the lack of qualified managers as a high/very high challenge. As a result, the share of expatriates working in Kenyan garment factories in technical and managerial roles is high. Costs are another factor for players considering sourcing in Kenya. While AGOA offers an advantage of 16 to 32 percent, the price difference to other sourcing markets is small, as producers have relatively higher labor costs with around USD 120 to 150 monthly wages for garment workers, thanks to the level of development in the Kenyan economy. Adding to that, 60 percent of the CPOs in our survey group noted that they perceive efficiency levels to be problematic in Kenya. Energy and other infrastructure costs can also be high, and the supply of power can be spotty. Power goes out several times a week in the Export Promotion Zone, for example, and firms there are forced to rely on generator power. But that is an expensive saving grace. According to the McKinsey report *Brighter Africa*[7], published in February 2015, generator power in Africa works out to be four times as expensive as power from the grid. So, the high costs of power, plus the instability of current supply, can be a pain point.

> "Without AGOA Kenya is not able to compete with other markets" *Manufacturer*

As in many developing countries the existing infrastructure is a hurdle for the requirements of the lead-time-focused garment industry. At the moment 42 percent of CPOs perceive inefficient hard infrastructure in Kenya as highly challenging, and 45 percent of CPOs perceive inefficient customs processes as highly challenging and another 9 percent perceive these as very highly challenging: the capacity of Mombasa port, which cannot serve mother vessels, and the prevalence of weighbridges on the roads adding waiting time to truck transport, which still accounts for 93 to 95 percent of transport. These are just two examples of the complications one can encounter in Kenya.

> "Raw material imports add significant lead time to production" *Manufacturer*

The current infrastructure issue is amplified by the reliance on imported fabrics, trims, and other supplies. It can add up to 40 days in transit, for fabrics manufactured overseas to come from abroad and make their way through customs and to the factory.

However, the government and local stakeholders are working to streamline key aspects of the transport and processing of garment inputs. Initiatives include the installation of a standard gauge railway, productivity improvements of customs processes, and port efficiency improvements.

In this context, it will be key to solve the high corruption, high crime rates, and lack of security as well as to ensure social compliance, which are perceived by international CPOs as the core compliance and risk issues in Kenya.

Besides building up further capacity, we believe there are a number of process improvements and efficiency measures that could significantly benefit the apparel industry in Kenya. In Exhibit 11, our CPO respondents ranked the challenges facing Kenyan apparel companies from toughest to least challenging. With efficiency improvements and diversification of its product offerings, Kenya's competitiveness and its global standing could be raised to a more competitive, higher-profile level. With improvement in these areas, Kenyan firms could win new buyers and expand their presence in the global apparel market.

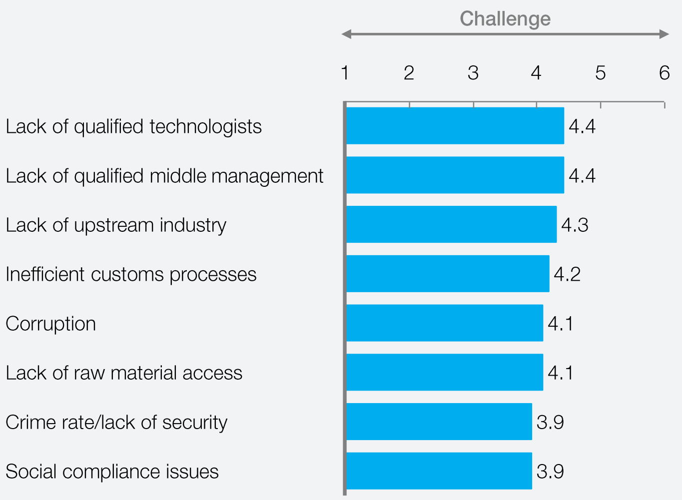
[7] McKinsey & Company, "Brighter Africa: The growth potential of the sub-Saharan electricity sector," February 2015, http://www.mckinsey.com/~/media/mckinsey/dotcom/client_service/EPNG/PDFs/Brighter_Africa_The_growth_potential_of_the_sub-Saharan_electricity_sector.ashx

Exhibit 11

To revive the positive trajectory and remain competitive closing the skill gap, improving efficiency and security is key

"What are the challenges for growth in apparel sourcing from Kenya?"

Average rate, 1 = no challenge to 6 = very high-impact challenge, n = 11



Efficiency improvement and diversification of product offering are key to increase Kenya's competitiveness on the global apparel sourcing market and to win new buyers

SOURCE: McKinsey CPO survey, January/February 2015

The Ethiopia opportunity

Though the first Ethiopian textile manufacturing mill was established back in 1939 in Dire Dawa Town, the industry remained loosely connected and growth was sluggish. While neighboring Kenya directly benefitted from AGOA, it has been less influential for Ethiopia despite the country’s inclusion in the act in 2001. Things finally began accelerating after 2005 when the government formed industry and development partnerships with Turkey and Germany. The launch of a Turkish-owned spinning mill in 2007 and its subsequent expansion of its business to knitting, dyeing, and garment confectioning, as well as its delivery of products to a major German buyer, fueled additional growth. Even today this early entrant is accounting for the majority of garment exports in Ethiopia. In 2010, Ethiopia’s government added the apparel industry to its Growth and Transformation Plan and launched its Textile Industry Development Institute. Since then the government has launched numerous initiatives to make the country more attractive for investors and to support the garment industry. In 2015 the second phase of the Growth and Transformation Plan started to support the industry even stronger to achieve highly ambitious plans.

Over the last two years, there has been a lot of buzz about Ethiopia, with leading European buyers starting to source from Ethiopia and large US players exploring the opportunity. At the same time a number of integrated players as well as CMT garment manufacturers from Turkey and Asia have committed to investing and starting business there, a number of enterprises from neighboring Kenya are now setting up shop in Ethiopia. From all this activity one might presume Ethiopia is an apparel powerhouse, but actually it has a modest profile on the global stage, accounting for 0.01 percent of total apparel exports, according to the World Trade Organization. Today as much as 60 percent of those exports are sent to Germany as a result of the duty-free agreement with the European Union and the historic development of the industry. Despite AGOA, the US only accounts for less than 10 percent of Ethiopian exports. But signs of change are appearing. A number of American and European buyers are taking a closer look at Ethiopia's potential and most recently the new National AGOA Center was opened to ensure that the free trade access to the US is streamlined and more available to Ethiopian exporters.

Why, then, is Ethiopia such a hot topic for apparel buyers? To start, it has more than 3.2 million hectares of land with suitable climate for cotton cultivation, yet barely 7 percent of that land is being used today. Those low utilization rates, combined with past planning errors, low crop yields and quality problems of the local cotton, are the reasons cotton for the local textile mills currently needs to be imported. Additionally, the broader supply industry is still lacking – a fact which is only recently starting to get attention with the foundation of the Ethiopian Industrial Inputs Development Institute. Sixty-nine percent of our CPOs rated the lack of raw materials as a challenge to doing business in Ethiopia.

> "The availability of workers is very high. Each day we screen workers and select the ones with the best skills" *Manufacturer*

However, the industry enjoys a relatively high degree of backward integration, with the largest garment exporters today operating from integrated factories. Though new textile mill projects, which can leverage low levels of electricity cost, are in development, the number of new investments in the less capital-intense CMT production is higher. Investors leverage the large supply of labor, as Ethiopia is the second most populous country in Africa. That said, the retention rate of workers is low and the supply of skilled workers and managers is thin. Ramping up factories, therefore, takes two or three years, and competition for labor with basic skill set could increase quickly.

> "The skill level is not what we have expected" *Manufacturer*

Buyers use Ethiopia today for basic, large-volume items. An analysis of Ethiopia's exports to Europe's 15 largest economies last year bears that out. Fully 46 percent of the country's exports to the EU-15 were comprised of T-shirts, and 31 percent were trousers. Cotton knitwear alone accounts for 81 percent of exports and organic cotton is an important part of the business for the largest manufacturers. Even so, the Ethiopian products make up a modest share of overall imports into the largest EU economies (see Exhibit 12).

As existing mills focus largely on cotton with some only working with cotton blends, the increase in CMT manufacturers that rely on imported fabrics might lead to an increase in products from man-made fibers. A look at the first CMT investors at the Bole Lemi Industrial

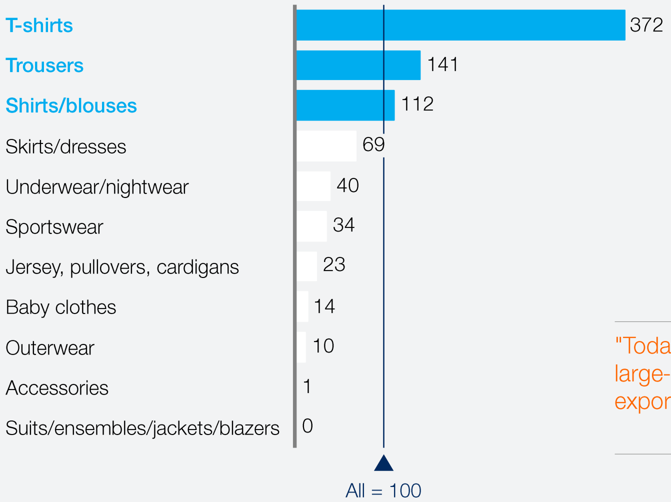
Exhibit 12

Today, Ethiopia's garment industry is mainly known for T-shirts

Penetration of Ethiopia clothing imports to EU-15, 2014

EUROPE

Indexed based on category import volume share (kg)



T-shirts account for 46% and trousers account for 31% of all clothing sourced from Ethiopia

Even in overrepresented categories Ethiopia's market share at EU-15 imports is low (T-shirts 0.2%, trousers 0.08%, shirts/blouses 0.06%)

"Today, the country is suitable for large-volume sourcing – otherwise exports are too complex"

Buyer

SOURCE: Eurostat; McKinsey

Zone shows indications of a further diversification of the garment portfolio exported from Ethiopia. From a cost perspective, Ethiopia is attractive to investors and buyers. Compared to other countries in the garment industry, Ethiopia's wages for workers are among the lowest globally at USD 60 per month, and work permit costs for foreign workers are less than 10 percent of what they would be in neighboring Kenya. Additionally, the country enjoys very competitive electricity prices, although the power grid suffers from instability. The country has a strong supply of hydroelectric plants, and while the power grid is not the most reliable, the Ethiopian government has undertaken efforts to build a separate grid for the new industrial zones under current development, and that may mitigate some of the uncertainty around power in the next few years.

“Raw material input is a lead-time challenge until the railway is finalized” *Manufacturer*

However, efficiency levels are an issue contributing to long lead times. Eighty percent of the CPOs in our survey rate production inefficiency as a challenge to the growth of apparel sourcing in Ethiopia. Today, production efficiency in Ethiopia runs between 40 and 50 percent. Besides the low skill level of workers and high churn rates, the skill gap in management and technologists is one of the drivers of this quality challenge. Fifty-seven percent of our CPO respondents characterized the lack of qualified middle management as highly or very highly challenging, and a full 65 percent of respondents noted the lack of qualified technologists in Ethiopia. Manufacturers we interviewed, on the other hand, see the largest technical skill gap in Ethiopia as dyeing. To address the skill gap the government started several programs, including its recent cooperative program with the Indian National Institute of Fashion Technology.

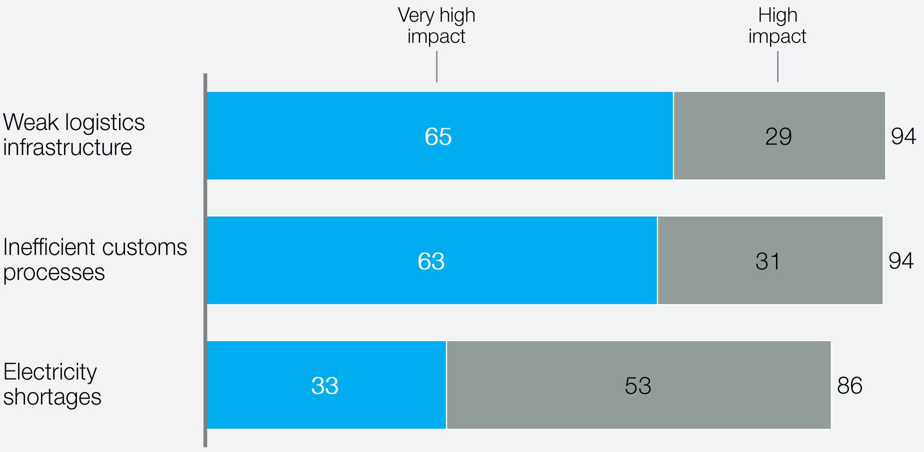
From a buyer's perspective, logistics and customs processes are the two big pain points. As Ethiopia is landlocked, it relies on the port in neighboring Djibouti for all sea-going exports. It can take cargo two or three days to get from the factory to the port, and once there, it faces seven days' wait to clear customs and take care of other formalities before it can be loaded on a ship (see Exhibit 13).

Exhibit 13

Logistics and customs are main pain points for buyers

"How much of a challenge are the following issues for the apparel sourcing growth in Ethiopia?"

Percent of respondents, n = 15



SOURCE: McKinsey CPO survey, January/February 2015; interviews; press

"The port is THE headache for us" *Manufacturer*

At the moment, the largest ships the port in Djibouti can accommodate are 40,000 dead-weight tonnage (DWT) vessels. There are plans to extend that to 100,000 DWT vessels by 2035, but for now this route to sea will be operating at a disadvantage to those in low-cost sourcing markets across Asia, many of which have easy access to feeder systems. Overall, the port at Djibouti may be marketed as a regional hub, but freight forwarders rate the current efficiency and performance of Djibouti's port below that of Mombasa's port.

“Customs processes are unpredictable – requirements and regulations are not clear” *Manufacturer*

In customs, bureaucracy is a real challenge for manufacturers, freight forwarders, and buyers, leading to unexpected delays. One manufacturer reports, “Our fabric got stuck in customs for one month, as the data sheet was not properly prepared.” Compliance levels are rated by CPOs as a noticeable, but not particularly difficult, challenge. The most important compliance challenges on the minds of CPO respondents: social compliance issues, corruption, and lack of law enforcement. For example, organic cotton cultivation recently suffered a setback after main garment manufacturers supplying European firms became entangled in landgrabbing accusations in the Omo Valley.

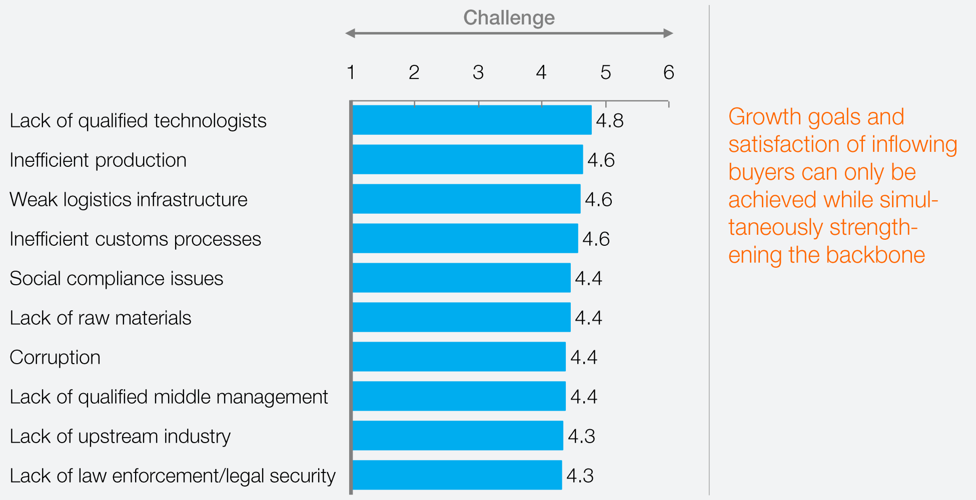
However, when asked to rank the challenges associated with doing business in Ethiopia, the CPOs still noted labor and efficiency issues as the most limiting (see Exhibit 14).

Exhibit 14

To realize its potential for growth, Ethiopia needs to overcome the skill gap, improve efficiency and infrastructure

"What are the challenges for growth in apparel sourcing from Ethiopia?"

CPO survey, average rate, 1 = no challenge to 6 = very high-impact challenge, n = 15



SOURCE: McKinsey CPO survey, January/February 2015

CREATING A SUSTAINABLE FUTURE

In order to fully tap the potential of East Africa, we believe the most important priorities for all parties are: 1) to collaborate broadly, with governments, suppliers, and buyers working together to make sustainable progress in the years ahead; and 2) to make every effort to ensure social and environment compliance. East Africa holds much promise for the apparel industry, especially as the industries in other sourcing markets around the world face rising cost, risk, or capacity issues. If all relevant stakeholders can work together to solve problems and build win-win solutions, the potential for true economic progress is great.

As part of our research effort, we wanted to step back and prioritize initiatives for all stakeholders, as joint collaboration is the surest route to success. The full list of suggestions appears in Exhibit 15, but we believe that public-sector officials and ministries in the region should focus on developing and executing their long-term development plans as well as on strengthening the regional trade structures and collaboration. The apparel industry is a good engine for improving the local economies, and any efforts to support supply industries or other backward integration should pay real dividends over the longer term. To the extent that infrastructure projects can assist the industry, officials may wish to consider supporting those efforts.

Exhibit 15

Stakeholders need to work together to tap the full potential of sub-Saharan Africa

GOVERNMENT
"Execute vision"
- Follow through with long-term plan for steady growth
- Diversify FTAs and support trade marketing
- Invest in infrastructure
- Foster local entrepreneurs and long-term FDIs
- Support backward integration and supply industries
- Establish market-oriented educational institutions

SUPPLIERS
"Think beyond"
- Improve productivity with new machinery and increase worker/management training
- Upgrade beyond CMT and diversify product portfolio
- Establish long-term partnerships with buyers
- Invest in backward integration

LARGE BUYERS
"Get real"
- Move beyond tests or insignificant shares
- Evaluate Africa as strategic option thinking beyond 2 - 3 years
- Proactively support supplier capability building (e.g., development, training)
- Establish optimal local sourcing setup to meet company objectives

Overarching recommendations
- Make every effort to ensure social and environmental compliance
- Work together to move from a short hype to a sustainable future

SOURCE: McKinsey

We believe the suppliers, themselves, should embrace performance improvements and management training. Also, we believe the time is right to move beyond CMT work and expand both product offerings and customer portfolios.

For buyers, we suggest that it might be the right time to move from conducting pilot projects to making long-term commitments to suppliers in the region. More importantly, we suggest buyers evaluate East Africa as a true strategic sourcing option, rather than a short-term experiment. Partnerships and investments in the region are needed, as the markets as they stand today are not ready to play in the global leagues.

□ □ □

While the challenges in East Africa must be acknowledged, we believe the potential is even greater. With the right sort of investment and knowledge sharing, the region offers rich resources, a large supply of workers looking for quality jobs, and the opportunity to diversify a concentrated sourcing strategy. If the elements of the program come together, East Africa won't overheat economically, but rather achieve a steady pace of growth with accompanying upgrades to productivity and worker skills. This is not only healthy for the governments and the local industry, but also the buyers themselves, who will build value for many years to come.

The authors wish to thank Ben Aschenaki, advisor in the Addis Ababa office, Cezanne Maherali, engagement manager in the Nairobi office, and Nischal Baijnath, consultant in the Johannesburg office, for their contributions to this article.

Authors:

Achim Berg is a principal in McKinsey's Frankfurt office and leader of the Apparel, Fashion & Luxury Group in EMEA.

Benedikt Berlemann is an engagement manager in the Düsseldorf office.

Saskia Hedrich is a senior knowledge expert in the Apparel, Fashion & Luxury Group in the Munich office.

Karl-Hendrik Magnus is a principal in the Johannesburg office.

Ben Mathews is a principal in the Cleveland office and leader of the US Purchasing & Supply Management Practice.

Bill Russo is a director in the Nairobi office and leader of the firm's East Africa offices.

If you have any queries, please contact:

Achim Berg
Phone: +49 (69) 7162-5528
E-mail: achim_berg@mckinsey.com

Apparel, Fashion & Luxury Group
April 2015
Designed by Visual Media Europe

www.mckinsey.com