

MARCH 2012

# McKinsey Quarterly

RETAIL PRACTICE

## Bangladesh: The next hot spot in apparel sourcing?

**Lower costs are an advantage for the country's ready-made-garment industry, but challenges remain.**

Achim Berg, Saskia Hedrich, and Thomas Tochtermann



**In 2010**, China dominated European and US markets for ready-made garments, accounting for about 40 percent of the import volume in each region. A recent McKinsey survey, however, found that 86 percent of the chief purchasing officers in leading apparel companies in Europe and the United States planned to decrease levels of sourcing in China over the next five years because of declining profit margins and capacity constraints.

Although Western buyers are evaluating a considerable number of sourcing options in the Far East and Southeast Asia, many chief purchasing officers said in the survey that they view Bangladesh as the next hot spot (exhibit). Indeed, our study of the country's ready-made-garment industry identified solid apparel-sourcing opportunities there—but also some hurdles.<sup>1</sup>

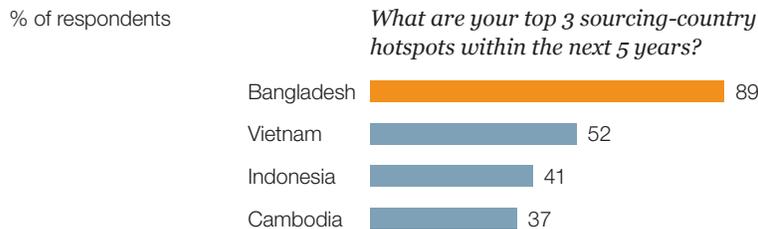
With about \$15 billion in exports in 2010, ready-made garments are the country's most important industrial sector; they represent 13 percent and more than 75 percent of GDP and total exports, respectively. McKinsey forecasts export-value growth of 7 to 9 percent annually within the next ten years, so the market will double by 2015 and nearly triple by 2020.

Our survey of chief purchasing officers found that European and US companies that focus on the apparel market's value segment plan to expand the share of their sourcing from Bangladesh to 25 to 30 percent by 2020, from an average of 20 percent now. Midmarket

<sup>1</sup> As part of the study, McKinsey surveyed 28 European and US chief purchasing officers at leading apparel companies from September to November 2011. They account for \$46 billion in total apparel-sourcing value and 66 percent of all apparel exports from Bangladesh to Europe and the United States. McKinsey also conducted a telephone survey of more than 100 local suppliers.

## Exhibit

### Many chief purchasing officers view Bangladesh as the next hot spot for sourcing in the ready-made-garment market.



Source: Sept–Nov 2011 McKinsey survey of 28 European and US chief purchasing officers from leading apparel companies that together account for \$46 billion in total apparel-sourcing value and 66% of all apparel exports from Bangladesh to Europe and the United States

brands, which generate about 13 percent of their sourcing value in Bangladesh, plan to increase that share to 20 to 25 percent over the same period. While growth in current product categories will drive some of the increase, 63 percent of the chief purchasing officers said that they want to expand into more fashionable or sophisticated items, such as formal wear and outerwear.

In our study, all the respondents identified attractive prices as the most important reason for purchasing in Bangladesh. They also said that price levels there will remain highly competitive in the future, since they expect significant efficiency increases to offset rising wage costs. Half of the respondents mentioned capacity as the second-biggest advantage of Bangladesh's ready-made-garment industry. With 5,000 factories employing about 3.6 million workers (of a total workforce of 74.0 million), Bangladesh is clearly ahead of other Southeast Asian suppliers in this respect. It also offers satisfactory levels of quality, especially in value and entry-level midmarket products.

### **Five challenges**

While Bangladesh presents some distinct advantages for sourcing, our study identified five challenges for apparel companies seeking to do more business there.

#### **Infrastructure**

Transportation bottlenecks create inefficient lead times for garments and delay deliveries to customers. This issue will become even more important in the future, since buyers want to source more fashionable products with shorter lead times.

Energy supply is a concern, too—90 percent of the more than 100 local suppliers we interviewed rate it as poor or very poor. The government has prioritized improvement in this area and started to upgrade power systems over the last two years, however.

#### **Compliance**

Nongovernmental and other organizations monitor Bangladesh for labor and social-compliance issues. While most European and US chief purchasing officers said in the survey that standards have somewhat or strongly improved over the past five years, they noted that suppliers vary greatly in their degree of compliance. Environmental compliance is just beginning to get attention.

#### **Suppliers' performance and the skilled workforce**

Our study found that the suppliers' productivity must improve not only to mitigate the impact of rising wages but also to close gaps with other sourcing countries and to satisfy new customer requirements for more sophisticated products. Two other concerns are a lack of investment in new machinery and technologies and the insufficient size of the skilled workforce, particularly in middle management.

### Raw materials

Bangladesh lacks a noteworthy supply of natural or artificial fibers, and its dependence on imports creates sourcing risks and lengthens lead times. Compounding the problem is the volatility of raw-material prices over the past few years. The development of a local sector would improve lead times.

### Economic and political stability

About half of the chief purchasing officers interviewed stated that they would reduce levels of sourcing in Bangladesh if its political stability decreased. The survey found that political unrest, strikes, and the ease of doing business are top of mind for respondents.

### Realizing the potential

The three main stakeholders—the government, suppliers, and buyers—must work together to realize the potential of Bangladesh’s ready-made-garment market. The government’s top three priorities for investment are infrastructure, education, and trade support.

What can European and US buyers do to secure Bangladesh as a sourcing powerhouse? At the highest level, they should review their approach from a full value chain perspective; for example, to increase the supply chain’s efficiency and transparency, they ought to expand their support for lean operations and electronic data exchange. Buyers should also build closer and long-term relationships with suppliers and, if necessary, rethink pricing negotiations with them. The most developed suppliers are choosing their customers more carefully and even breaking off ties with long-established ones.

Buyers must also improve their own operational execution. Their long response times, the complexity of internal procedures involving the merchandising and sourcing functions, and a high number of last-minute changes slow down the overall process. In addition, buyers must actively pursue compliance efforts.

The full report, *Bangladesh’s ready-made garments landscape: The challenge of growth* (PDF), is available on the McKinsey & Company Web site. [o](#)

**Achim Berg** is a principal in McKinsey’s Frankfurt office, **Saskia Hedrich** is a consultant in the Munich office, and **Thomas Tochtermann** is a director in the Hamburg office. Copyright © 2012 McKinsey & Company. All rights reserved.