



# **CAMBODIAN GARMENT SECTOR: BUYER SURVEY RESULTS**

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The Multi Fiber Arrangement, or MFA, which ends on 1 January 2005, has provided many developing countries with access to markets and transitional shelter from the rigors of global competition. Under MFA protection, the Cambodian garment sector has grown from exporting \$20 million in 1995 to over \$1.4 billion in 2003. Starting January 1, Cambodia's garment exports will no longer be determined by the amount of quota it has been allocated by governments in importing countries. Instead, the success of the industry will depend on its competitiveness.

The Royal Government of Cambodia asked the Foreign Investment Advisory Services (FIAS), a joint service of the International Finance Corporation (IFC) and the World Bank, to assist the Ministry of Commerce and the industry prepare for the end of the quota regime. As the first step, FIAS surveyed key current buyers from Cambodia about (a) the factors influencing their purchasing decisions; (b) their perception of the Cambodian industry's performance on these issues relative to regional competitors, and (c) their plans in Cambodia post-MFA<sup>1</sup>. This note summarizes the results of that survey.

Worldwide, textiles and clothing is a \$395 billion industry, employing more than 24 million workers in 200 countries. In many of these countries the quota system has encouraged the creation of garment industries that are not competitive, forcing international buyers to source in countries with quota allocation. These industries will almost certainly die away in the next few years, resulting in closed factories and significant job losses. But countries that are competitive will find their market share increasing.

Cambodia's garment industry represents less than 1% of the global industry, but it is of great importance to the country because it employs 260,000 workers, represents more than 80% of the country's total exports and 12.4% of GDP. Cambodia's reputation as a "sweatshop-free" country stems from a unique provision in its trade agreement with the US. Starting in 1999, Cambodia could earn an increased quota allocation for demonstrated improvements in working conditions. A monitoring system developed and implemented by ILO, with support from the US Department of Labor, the Government of Cambodia, and the Garment Manufacturers Association of Cambodia (GMAC) has virtually eliminated the worst labor abuses such as child labor and sexual harassment, with a unique monitoring system that is industry-wide, and transparent.

### ***Survey of buyers intentions***

A survey was conducted in June 2004 to determine current buyers' sourcing plans post-2004 with respect to Cambodia, the conditions that would be attached and the importance of CSR-related issues compared with other sourcing considerations. The survey also asked buyers for

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<sup>1</sup> The garment buyers survey was financed by FIAS, with additional support from the Agence Française de Développement (AFD) which is co-financing this study in the context of the implementation of a project for the promotion of the garment sector's exports in Cambodia, made on behalf of the French government program to strengthen trade capacities in developing countries.

their impressions of the performance of Cambodia and its regional competitors (Thailand, Bangladesh, China, and Vietnam) on a series of factors related to industry competitiveness.

The survey was completed with 15 of the largest US and EU buyers, together accounting for 45% of Cambodia's garment exports, using one-on-one structured interviews. Interviews targeted senior sourcing staff as opposed to compliance and CSR staff, in order to avoid any bias towards CSR. Interviewees understood the survey to be about apparel competitiveness; they were not initially aware of the CSR focus.

### ***Sourcing criteria***

Buyers were asked to rate the importance of 12 **country**-specific sourcing criteria on a scale of 0 (no importance) to 5 (critical importance). Buyers were not asked to rank order the criteria, but the highest rating was assigned to labor standards, followed by trade preferences (including quota and tariff reductions, etc.) and then access to materials and supplies.

When asked to rate the performance of specific countries on each of the sourcing criteria listed, Cambodia clearly ranked ahead of regional competitors on labor standards. Other key results:

- Buyers consider that Cambodia (3.65) has an advantage over Bangladesh (2.35), Thailand (3.13), Vietnam (2.64) and China (2.87) on labor standards.
- Other advantages enjoyed by Cambodia over its competitors are tariff preference and union rights
- Cambodia ranks less well on access to international materials and supplies; political and economic stability; and customs efficiency

When asked about **factory**-specific criteria, buyers listed price, health and safety practices, and quality as their top considerations. At the factory level, Cambodia's strengths include the level of health and safety practices, workforce skills and productivity and product quality. But on none of them does Cambodia rank highest. Its weaknesses are price/production costs, production capacity and the range of services offered.

### ***Sourcing intentions***

The survey shows that key overseas buyers from Cambodia's garment industry currently plan to retain or increase their purchasing – not withdraw, as many Cambodian factory owners fear.

- 60% of the buyers interviewed say they plan to increase their garment purchases from Cambodia
- 40% say they will “wait and see”
- None has plans to buy less

Of the buyers interviewed a greater number of European buyers (83%) plan to increase than American buyers (37%) who tend to have more a “wait and see” attitude. The buyers who say that will increase orders generally have very low level of orders in constrained categories.

### ***Monitoring of labor standards***

- 79% of buyers consider auditing of labor standards to be crucial after January 1<sup>st</sup>. Only 7% rate it as not important.

- Buyers do not appear to have detailed knowledge about the ILO monitoring scheme, but do see the program as credible, rating it second highest only to their internal auditing systems.
- Buyers also state that improved labor standards have positive effects on accident rates, workplace productivity, product quality, worker turnover and absenteeism. They consider improved labor standards to have a negative effect on price
- 43% of buyers believe consumers find labor compliance of major or critical importance (an additional 43% cite moderate importance).

### ***Challenges and Opportunities***

Buyers identified the following key challenges facing Cambodia's industry at the end of the quota system:

- Intensified competition from China
- Improvement of the sourcing of raw materials
- Speed to market
- Education and skills of workers
- Balancing increased labor standards with competitive prices and labor costs
- Productivity
- Reducing corruption,
- Improving infrastructure

Buyers largely agree that Cambodia ranks fairly well on quality, but has progress to make on price/costs and delivery lead times if it is to be competitive in the post-MFA world. Buyers were insistent that compliance with labor standards is not sufficient for the Cambodian garment industry to survive and grow. Seventy-five percent of buyers surveyed said that red tape, corruption and high energy costs must also be tackled, if production costs are to be competitive<sup>2</sup>. Because garment production costs in China are estimated to be 15-20% lower than in Cambodia, corruption and other costs of doing business can render Cambodia uncompetitive.

The results confirm the existence of a market niche that cares about labor standards. The Cambodian garment sector has first mover advantage on this issue – the only issue on which buyers believe it outperforms its regional competitors. The country needs to build this into a sustainable competitive advantage if it is to retain its buyers and investors and improve the industry's performance more generally.

FIAS, the Ministry of Commerce, GMAC and ILO will collaborate on adapting the existing labor monitoring system away from triggering quota bonuses by US government officials towards providing information for the industry's overseas buyers, and will also consider implications for other industry sectors. Final recommendations will be made in a workshop in February 2005.

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<sup>2</sup> The private sector estimates that unofficial payments cost firms an average of 5.2% of total sales revenue. Cambodia Seizing the Global Opportunity: Investment Climate Assessment and Reform Strategy, World Bank, August 2004.